

1970

Critical Evaluation of the Present and Future Role of the Local Practitioner.

John Moody Malloy

Louisiana State University and Agricultural & Mechanical College

Follow this and additional works at: https://digitalcommons.lsu.edu/gradschool_disstheses

Recommended Citation

Malloy, John Moody, "Critical Evaluation of the Present and Future Role of the Local Practitioner." (1970). *LSU Historical Dissertations and Theses*. 1868.

https://digitalcommons.lsu.edu/gradschool_disstheses/1868

This Dissertation is brought to you for free and open access by the Graduate School at LSU Digital Commons. It has been accepted for inclusion in LSU Historical Dissertations and Theses by an authorized administrator of LSU Digital Commons. For more information, please contact gradetd@lsu.edu.

71-6588

MALLOY, John Moody, 1938-
CRITICAL EVALUATION OF THE PRESENT AND FUTURE
ROLE OF THE LOCAL PRACTITIONER.

The Louisiana State University and
Agricultural and Mechanical College, Ph.D.,
1970
Accounting

University Microfilms, Inc., Ann Arbor, Michigan

© 1971

JOHN MOODY MALLOY

ALL RIGHTS RESERVED

Critical Evaluation of the Present
And Future Role of the
Local Practitioner

A Dissertation

Submitted to the Graduate Faculty of the
Louisiana State University and
Agricultural and Mechanical College
in partial fulfillment of the
requirements for the degree of
Doctor of Philosophy

in

The Department of Accounting

by

John Moody Malløe

B.B.A., Southern Methodist University, 1961

M.B.A., Southern Methodist University, 1966

August, 1970

PLEASE NOTE:

Some pages have indistinct
print. Filmed as received.

UNIVERSITY MICROFILMS.

ACKNOWLEDGMENTS

Special thanks must be given to the Louisiana local practitioners who gave so freely of their valuable time to complete a lengthy questionnaire in a professional manner. Moreover, some of the same local CPAs also consented to participate in personal interviews. Active participation of the Louisiana local practitioners made the findings of the paper possible.

Much indebtedness is owed to my dissertation committee. Special thanks must be given to the accounting members of the committee consisting of Dr. Elliott, Dr. Morrison, and Dr. Swyers who gave such constructive advice in the areas of the paper pertaining to accounting. Dr. William E. Swyers, Chairman of the committee, provided invaluable advice and assistance in the preparation of the paper.

The paper would not have been possible without the able typing of Mrs. R. F. Richey. Finally, my wife's assistance in typing the original draft and the other sacrifices she and my daughter made are certainly greatly appreciated.

TABLE OF CONTENTS

ACKNOWLEDGMENTS	i
LIST OF TABLES	iv
LIST OF ILLUSTRATIONS	ix
ABSTRACT	x
Chapter	
I. INTRODUCTION	1
II. A REVIEW AND ANALYSIS OF THE ACCOUNTING NEEDS OF THE AVERAGE SMALL BUSINESS	8
Background Information	
Profile of Typical Accounting System	
Use of Selected Accounting Techniques	
Need for Outside Advisors	
Summary of Chapter	
III. AN ANALYSIS AND EVALUATION OF THE CURRENT SER- VICES PERFORMED BY LOCAL PRACTITIONERS	59
Information About Questionnaire	
General Types of Services	
Common Body of Knowledge	
General Types of Management Services	
Evaluation of Data	
Summary and Conclusion	
IV. AN EXAMINATION AND DISCUSSION OF THE PRESENT AND POSSIBLE FUTURE EXTENSION OF AUDITING SER- VICES PROVIDED BY LOCAL PRACTITIONERS	119
General Types of Audit Services	
General Areas of Possible Audit Extension	
A Review and Analysis of a Proposed Attest Extension	
Conclusions	
V. AN INVESTIGATION AND DISCUSSION OF THE REFERRAL SYSTEM OF LOCAL PRACTITIONERS	160

TABLE OF CONTENTS (Continued)

Chapter

Analysis of the Need for Referrals
Referral System of Various Selected
Professions
Accounting Referral System
Forward Fees
Conclusions

VI. AN ANALYSIS AND EVALUATION OF THE PROFESSIONAL DEVELOPMENT PROGRAMS OF LOUISIANA LOCAL PRAC- TITIONERS	216
--	-----

Effect of Knowledge Explosion
Review of Professional Development Program
Professional Development Courses
Review of In-Depth Continuing Educational
Courses
Evaluation of Data
Summary and Conclusions

VII. AN ANALYSIS AND EVALUATION OF THE PERTINENT PROBLEM OF INDEPENDENCE AND THE LOCAL PRAC- TITIONER	258
---	-----

Background Information
Areas of Possible Conflict of Interest
Evaluation of Data
Summary and Conclusions

VIII. SUMMARY AND CONCLUSIONS	290
---	-----

SELECTED BIBLIOGRAPHY	305
---------------------------------	-----

APPENDIX A: FACSIMILES OF THE LOUISIANA LOCAL FIRM, LOUISIANA SOLE PRACTITIONER, AND NATIONAL CPA FIRM WITH OFFICES IN LOUISIANA QUESTIONNAIRES	316
--	-----

APPENDIX B: SUMMARIZATION OF RESPONSES TO QUESTION- NAIRES NOT PRESENTED IN THE MAIN BODY OF THE PAPER	337
--	-----

VITA	348
----------------	-----

LIST OF TABLES

Table	Page
1. Analysis of Response to the Mailing of the Local Practitioner Questionnaire in the State of Louisiana by Geographical Area . . .	62
2. Analysis of Responses to the Mailing of the Local Practitioner Questionnaire in the State of Louisiana by Present Size of Professional Staff	63
3. General Types of Services Performed Or Expected to Be Performed by Louisiana Local Practitioners for the Years 1965, 1968, and 1971 According to the Size of Professional Staff	65
4. Analysis of the Degree of Knowledge Possessed by the Partner Most Knowledgeable in Each Selected Area	75
5. Analysis of the Degree of Frequency Which the Clients of Local Practitioners Use Computer Facilities in Processing and Analyzing Their Data	86
6. Analysis of the Extent to Which Management Services Are Presently Performed by Louisiana Local Practitioners	92
7. Analysis of the Louisiana Local Practitioners' Projection of Demands for Management Services in 1972	95
8. Analysis of the Occurrence of a Separate Management Services Department and Personnel among Louisiana Local Practitioners .	101
9. Analysis of the Use of Computer Aids by Louisiana Local Practitioners	107
10. General Types of Services Performed by Louisiana Local Practitioners in Conjunction with the Rendering of an Opinion on Financial Statements	120

Table	Page
11. Percentage of Louisiana Local Practitioners Whose Audit Program Contains an Internal Information System Questionnaire	129
12. Percentage of Louisiana Local CPA Firms Which Have Clients Who Have Offices in Other States And/or Operate in Foreign Countries	161
13. An Analysis of the Occurrence of Combining of Staffs among Louisiana Local Practitioners for the Purpose of Providing Management Services	167
14. An Investigation of the Occurrence of Joint Management Services Ventures among National CPA Firms And Louisiana Local Practitioners .	168
15. An Analysis of the Method Or Methods Used by Louisiana Local Practitioners in Selecting a Referral	179
16. Investigation of the Frequency: (1) in Which Louisiana Local Practitioners Make Referrals, (2) in Which Referrals Are Rejected by Local Practitioners and National CPA Firms, and (3) in Which Encroachments Occur	181
17. An Analysis of the Frequency Which National CPA Firms Explain Their Management Services Work to Louisiana Local Practitioners And the Occurrence of Referrals Which Result from Recommendations from Louisiana Local Practitioners	183
18. An Analysis of the Willingness of National CPA Firms to Both Accept Referrals from Louisiana Local Practitioners And to Extend Their Services Beyond the Specific Engagement	185
19. An Analysis of the Louisiana Local Practitioner's Reluctance to Refer Due to the Perceived Fear of Encroachment	190
20. An Analysis of the Perceived Obligation of Louisiana Local Practitioners to Point Out to Clients Problem Areas in Fields in Which the Local CPA Is Not Competent to Render the Required Services	192

21.	An Investigation of the Action Generally Taken by a Louisiana Local CPA Who Discovers a Deficiency in the Internal Information System	193
22.	An Analysis of the Louisiana Local Practitioner's Willingness to Accept a Referral and His Philosophy Pertaining to Extension of Services Beyond the Specific Engagement .	195
23.	An Analysis of the Louisiana Local Practitioner's Preference for a Referee When a CPA And an Outside Consultant Are Equally Competent	198
24.	An Analysis of the Louisiana Local Practitioner's Present Satisfaction With Professional Code of Ethics Rule 5.02 And Their Opinion As to the Propriety of Altering Rule 5.02 with an Absolute Ethical Restriction Clause	202
25.	An Analysis of the Use of Written Agreements among Louisiana Local Practitioners Not to Extend Services in Referral Engagements . . .	203
26.	An Investigation of the Willingness of National CPA Firms to Enter into Written Agreements Not to Compete	205
27.	Analysis of the Frequency of Receiving And/Or Giving of Forwarding Fees among Louisiana Local Practitioners	210
28.	Analysis of the Methods Employed by Louisiana Local Practitioners to Obtain Knowledge in Selected Areas	222
29.	An Analysis of the Frequency of Participation in Professional Development Courses by Louisiana Local Practitioners	224
30.	An Analysis of Louisiana Local Practitioner Participation in Staff Training Programs . .	233
31.	An Analysis of the Effectiveness of Self Study Aids by Louisiana CPA Firms in Management Advisory Services and Taxation . .	236
32.	An Analysis of the Average Yearly Time and Money Spent in Professional Development	

Table	Page
Activities by Louisiana Local Practitioners	238
33. An Analysis of the Extent Selected Professional Periodicals Are Read by Louisiana Local Practitioners	242
34. An Analysis of the Louisiana Local Practitioner's Potential Demand for University Sponsored Continuing Educational Courses	247
35. An Analysis of the Louisiana Local Practitioner's Potential Demand for University Sponsored Continuing Educational Courses by Selected Knowledge Areas	248
36. An Analysis of the Frequency of Use of Different Supervisory Partners When Management Advisory Services And Independent Auditing Services Are Both Provided for the Same Client	272
37. An Analysis of the Occurrence of a National CPA Firm Located in Louisiana Acting in the Role As a Controller for a Small Business	275
38. An Investigation to Determine If the National CPA Firms Located in Louisiana Who Act As a Controller Plus Provide Auditing Services for the Same Small Client Have Separate Partners in Charge of Each Assignment	276
39. An Analysis of the Degree of Frequency to Which Louisiana Local Practitioners Render Management Advisory Services to Competing Clients in Similar Decision Making Areas	279
40. An Analysis of the Frequency at Which the Local Practitioner's Clients Have Established Audit Committees	282
41. Analysis of the Composition of Louisiana Local CPA Firms	337
42. Analysis of the Extent of Participation by Louisiana Local Practitioners in Community And Professional Activities	338

Table

Page

43.	Analysis to Determine Whether Louisiana Local Practitioners Were Instrumental in Persuading Clients with Computer Facilities to Install Such Equipment	339
44.	Analysis of How the Louisiana Local Practitioners Perceive Client's Need for Management Services Work And the Frequency with Which Types of Management Services Are Explained to Clients	340
45.	Analysis to Determine Whether Or Not Louisiana Local Practitioners Who Give And/Or Receive Forwarding Fees Make Their Clients Pay for This Service in Higher Than Normal Fees	341
46.	Analysis of the Basis for Determining the Amount of the Forward Fee	342
47.	Analysis of Louisiana Local Practitioners Who Have Experienced Encroachment in Order to Determine the Frequency of Such Encroachment	343
48.	Analysis of Percentage of Gross Fees by Type of Services Derived by Louisiana Local Practitioners for the Years 1965, 1968, and 1971	344
49.	Analysis of the Extent to Which Clients of Louisiana Local Practitioners Request Selected Services	345

LIST OF ILLUSTRATIONS

Figure	Page
1. Illustration of the Extent to Which a Typical Accounting System of a Small Business Satisfies the Requirements of an Adequate Accounting System	27

ABSTRACT

The principal objectives of the study are to (1) analyze and evaluate the use of accounting data in small businesses, (2) to determine what accounting services are needed by the average small firm, (3) to determine what services the local practitioners are actually providing local entrepreneurs, (4) to analyze and evaluate the overall effect of the knowledge explosion, attest function, widening scope of accounting services, referral system, and professional ethics on the type and quality of services offered by local CPA's, and (5) to propose various methods which might be taken to improve the quality and types of services offered by local practitioners in order to enable their small clients to operate in a more efficient, economical, and effective manner.

The study has found that the overwhelming weight of the evidence indicates that the typical small business is not operated in an efficient manner. The major problem area facing the average small business appears to be the failure of the internal information system to provide accurate, material, relevant, and timely data in a usable form for use in formulating management decisions. The small busi-

ness has an urgent need for local practitioners to conduct a thorough review and analysis of the internal information system.

The evidence further indicates that Louisiana local practitioners provide their small business clients with a wide disparity of types and quality of services. Local practitioners perform a variety of management services, but generally not on a systematic, organized basis. Moreover, over sixty per cent of the smaller and medium sized local CPAs do not frequently provide their audit clients with a management letter pertaining to the internal information system. Thus, the majority of local practitioners are not providing their small business clients with the optimum type of relevant services.

The study found that the major stumbling block which prevents the local practitioner from performing an optimum level of services to his small business clients is due to the knowledge explosion. The knowledge explosion has overwhelmed most local CPAs particularly in such areas as EDP, modern managerial accounting techniques, and statistical sampling methods.

The fact is noted that local CPAs are reluctant to refer their clients to another CPA when conditions warrant such an extension mainly due to the fear of encroachment. Additionally, local practitioners are especially susceptible to conflict of interest when providing certain types of management services.

Several constructive steps may be taken by the accounting profession, the individual local practitioner, and the small businessman to improve the quality of accounting services and the operating efficiency of the small firm. It is suggested that the local practitioner can provide the greatest assistance to small business by reviewing the firm's internal information system and reporting the results of such a review in the form of a mandatory internal information report.

Various steps can also be taken to combat effectively the interrelated problems of possessing a minimum acceptable knowledge level, conflict of interest, and selecting a referee when the client needs one. The solution of the interrelated problems leads to the need for accrediting specialists, establishing a formal referral system, adopting a continuing educational requirement, providing a larger selection of in-depth professional development courses, and adopting a five year minimum educational requirement.

The local CPA's work of the future will doubtlessly be much more challenging and demanding with much less emphasis on detailed routine work. The progressive local practitioner who adopts an adequate professional development program faces a promising future. Conversely, the knowledge explosion will overwhelm the less progressive CPA. Additionally, the creative local practitioner who can successfully implement his ideas will be at the forefront of the accounting profession.

CHAPTER I

INTRODUCTION

Background information.--Accounting has been called the language of business. The roots of accounting go back at least to 3600 B.C. Businesses started using the double-entry system in the fourteenth century as trade became more complex, as merchants had to delegate tasks to subordinates, and as joint ventures and partnerships became popular forms of organizations.¹ However, at the turn of this century most small businesses still had no accurate method of determining their profit or loss at the end of each year's operation because they did not keep any formal records.

Most small firms did not begin to keep records until the passage of the federal income tax law in 1913. This law requires businesses to keep whatever records that are necessary to correctly reflect income. As businesses became more complex and as the economy also became more dynamic, businessmen demanded more information to aid in decision making functions. Generally, larger firms first proceeded to use

¹Raymond De Roover and Iris Origo, "The Beginning of Double-Entry Bookkeeping in the Fourteenth Century," Vol. I of The World of Business, ed. Edward C. Bursk, Donald T. Clark, and Ralph W. Hidy (New York: Simon and Schuster, 1962), p. 81.

cost and analysis systems in addition to their basic accounting system. Later the larger firms proceeded to more advanced systems comprised of such tools as integrated sales forecasting, profit planning, and operations research techniques. New techniques, such as life-span costs, are being developed at a rapid rate in order to improve the accounting information system for aiding in decision making functions.

Generally, small firms will not need the sophisticated accounting system of a large firm. However, in order to operate successfully in our present day economy, businesses regardless of their size need accounting data which extends beyond the basic financial statements. Small firms need an internal information system which not only provides the typical financial accounting data, but more importantly provides data pertaining to the functions of decision making and operational control. In the retail field, for example, the merchandise management accounting system was developed in the 1950's to provide data for decision making at the product item level. This system helps to supply answers to such key questions as what merchandise to buy; what is the optimum price; which items should be promoted; which items should be discontinued; and, it supplies answers to other pertinent questions. The information developed through the use of this system may, also, be used as a control for evaluating the profitability of the store's merchandising division and the efficiency of its operating division.

The merchandise management accounting system and other accounting systems promise no miraculous solutions to managerial problems. However, these accounting systems do provide to management pertinent information which enables the firm to operate more efficiently, effectively, and economically by making decisions on a more informed basis.

Purpose of paper.--Unfortunately, many of the small businesses have not been able to meet the demands of an ever increasing complex and dynamic economy. During the last decade, for example, retail store failures were approximately 250 per cent greater than in the previous decade.¹ Recent small business research studies have found that many small business failures are caused by the failure to use accurate accounting data in the decision making function. One study of the causes of business failures in the retailing and commercial service trades found that a heavy preponderance (over eighty per cent) of these failures stemmed from the owner's inability to avoid certain conditions which the analysis of adequate records would have disclosed in time to take early corrective action.²

Almost all of the small firms employ someone else to do their accounting work. Generally, the local practitioner

¹Robert D. Erwin, Merchandise Management Accounting--A Guide to Item Profitability for Small and Medium Retail Stores (Stillwater: Oklahoma State University, 1964), p. 13.

²U. S., Small Business Administration, Recordkeeping Systems--Small Store and Service Trade, by Elizabeth Heidbreder (Washington, D.C.: Government Printing Office, 1962), p. 1.

will perform all or most of his services for the small firm. However, the local practitioner appears to be concentrating on write-up work, preparing tax returns, and rendering an opinion on the financial statements rather than providing management service advisory assistance.

The paper examines and evaluates the present role played by the local practitioner and the accounting profession in the process of providing relevant services to small businesses. The paper analyzes how well the practitioner fulfills his obligations as demanded by society and his profession. The paper projects the future role of the local practitioner and the changes required of various institutions in order to achieve the evolving requirements of the accounting profession.

The paper is divided into six sections with the exception of the introduction and summary and conclusion sections. The purposes of the proposed study are to (1) analyze the use of accounting data by the small firm and summarize the present accounting needs of the typical small business, (2) analyze and evaluate the current services performed by local practitioners, (3) examine and discuss the need for extending the scope of accounting services to small firms, (4) examine and discuss the effectiveness of the referral system of local practitioners, (5) examine and evaluate the professional development program of local practitioners in order to determine their preparedness to perform a competent level of services, and (6) analyze and

evaluate the pertinent problem of independence and the local CPA.

Significance of the research problem.--Almost in its entirety the survival of the local practitioner is dependent upon the future success of small businesses due to the fact that the majority of his services are performed for the small firm. Conversely, the economic welfare of approximately seven million owners, and even more millions of employees, will be determined almost entirely by the extent to which small businesses can survive and prosper in our complex and changing economic system.

Methodology.--Secondary sources are the major source of information for the first section pertaining to the accounting needs of the small business firm. Ample material should be available in the field due to the fact that the Small Business Administration has sponsored a great deal of research in this area.

Material for the other major sections were drawn mainly from primary sources. Questionnaires were used as the major source of material. Questionnaires were sent to all the local practitioners located in the state of Louisiana who are engaged in the full time practice of public accountancy. Interviews were conducted as required. A short questionnaire was also sent to each national Certified Public Accounting firm with offices in the state of Louisiana. The fact is noted that the Louisiana local prac-

titioners may not be completely representative of the average practitioner, but it is felt that the difference should not be significant. The primary and secondary sources cited are felt to be adequate for the accomplishment of the stated objectives.

Hypothesis.--Most small businesses do not use accounting data in the decision making process which results in inefficient operations. Local practitioners, on the other hand, generally do not supply small firms with the most relevant services possible. Such interrelated factors as the knowledge explosion, widening scope of accounting services, inadequate referral machinery, conflict of interest, and deficient professional development programs have led to the situation where the average local CPA is not able to offer a comprehensive level of quality services in all the phases of accounting. Further hypothesized is the fact that the local practitioner, especially the smaller practitioner, must offer a limited variety of services in the future in order to perform his work in a competent manner.

Definitions.--The term local practitioner will be defined as including both full-time, individual practitioners and local firms. An individual practitioner is one who practices entirely alone or with the aid of several staff assistants. The term local firm pertains to those whose operation is confined to the state of Louisiana. The local firms generally operate from one or two offices with the

staff tending to be small and seldom numbering over fifty.

No precise definition of small business is given because the definition changes with the passage of time. A business which was large in 1900 might be classified as small in 1969. The definition of small business by the Small Business Administration is the generally considered definition of a small concern. The Small Business Administration's definition of a small business varies not only by industry, but also by subclassifications within the industry. However, certain similarities are common to all small firms. The firm must be independently owned and operated and not be dominant in its field of operation. Thus, some businesses which would be classified as "small" by the Small Business Administration standards may be "large" in organization, operation, and finance. For the purpose of this paper, the definition of small business by the Small Business Administration will be the accepted one. Some typical characteristics exist which assist in making the distinction between large and small businesses. The small business, for example, generally operates in a local area, it will not tend to dominate its field of operation, capital and ownership will tend to be supplied by local groups, and generally a close identification is found between management and owners.

CHAPTER II

A REVIEW AND ANALYSIS OF THE ACCOUNTING NEEDS OF THE AVERAGE SMALL BUSINESS

Background Information

Small businesses are a vital factor in the economy.--

The purpose of this chapter is to analyze the use of accounting data by small enterprises and to determine the accounting needs of the average small business. Approximately seven million small business proprietors are found in America and even more millions of small business employees. Thus, in terms of the livelihood of our society the small firm is an essential factor in our economy. Furthermore, the small business enables many individuals to become more self-sufficient and to satisfy more completely their higher level needs.

Small businesses are an important factor in our economy for various other reasons. Many of the inventions which have extended the state of the arts have come from small firms. Mr. F. B. Jewett, former president of the Bell Laboratories, Inc., stated that "the chances are ten to one that the fundamental idea will come from outside the big

laboratories."¹ Many of the large present day scientifically oriented firms, such as Texas Instruments, were small businesses or were not even in existence twenty years ago. Many of the large present day corporations in other industries were also at one time small businesses.

The small firm is also a fertile proving ground for creative ideas. While many of these ideas are not accepted by the market place, a few of the ideas will become truly fundamental. Many present day large corporations, such as Kentucky Fried Chicken, Pepperidge Farm, Inc., and Gerber Products Company grew from the creative ideas of individuals. Therefore, the evidence suggests that small businesses are an important source of fundamental ideas which are sometimes responsible for the growth of entirely new industries.

Small businesses also have the tendency to maintain and increase competition. The availability of many small firms enables the consumer to have a wider variety of services, products, and prices which would probably not be available if the industry were served by only a few giant corporations.

There are certain industries which are particularly suited for the small proprietor. The service industry, for example, is dominated by small businesses. On the other hand, the small firm also plays a vital role in industries which are dominated by a few giant corporations. Naturally,

¹Small Business, Its Role and Its Problems (Washington, D.C.: Chamber of Commerce of the United States, 1953), p. 16.

one would not expect to find a small aluminum producing firm due to the enormous capital investment requirements. However, small firms do play an essential role in many industries which are dominated by a few huge corporations by serving as satellite firms. The small satellite firms perform such activities as subcontracting, distributing, servicing products, and using the large corporation's semi-finished products. The prominent role played by satellite companies demonstrates the important part played by small businesses even in industries dominated by a few immense corporations.

The superior weight of the evidence does indicate that small businesses do play a vital role in our economy due to their own special traits. They provide livelihood for numerous individuals and are the proving ground for various fundamental ideas and inventions. Small proprietors dominate some fields, provide strong competition in some, and offer a unique service as satellite firms in other industries. Thus, it is important to our society that small firms operate in an efficient manner since they serve such an essential function in the economy.

Many small firms do not operate efficiently.--

Estimations have been made indicating that between 450,000 and 500,000 new businesses will begin operation in 1969 with new franchise outlets accounting for between five and ten

percent of this total.¹ The fact that the number of new businesses has been steadily increasing in the last several years is due largely to the presence of a favorable economic climate. For example, the projected increase in new businesses for 1969 represents approximately a twenty-five per cent increase over six years ago. More than fifty per cent of these new companies will enter the retail field which has traditionally been the most popular industry for small businesses. Nevertheless, the fastest growing fields for small firms in recent years has been recreation and service.

Evidence suggests that many of the beginning businesses will not survive in our ever changing and complex economy. Based on prior experience, the estimation can be made that only one out of two new businesses launched in 1969 will be in existence eighteen months from the date of their inception and that only one out of five of the new firms will be in existence in 1979.² While many corporations operate with satisfactory profits, federal income tax statistics of business income indicate that approximately one out of seven small firms operate at a loss.³ The data

¹John A. Prestbo, "More Individuals Buck Alarming Failure Rate to Start Own Firms," The Wall Street Journal, April 10, 1969, p. 1.

²Rowena Wyant, "Business Failures," Dun's Review, October, 1968, p. 145.

³U. S., Treasury Department, Internal Revenue Service, Statistics of Income 1965-Business Income Tax Return (Washington, D. C.: Government Printing Office, 1968), pp. 26-210.

support the fact that some small firms are operating with satisfactory net income levels, but a significant number are operating at less than optimum efficiency.

Beginning small business managers can be expected to have a widely varying degree of management talent due to the large number of businesses commencing operation each year. A study of small business failures in Alabama by the University of Alabama found that "many of the firms investigated were never serious contenders for inclusion in the ranks of established businesses."¹ The study further found that the management of new businesses suffered from a variety of defects such as insufficient capital, lack of experience, little or no knowledge of demand, and insufficient knowledge of business problems. The results of the above mentioned study and the large new business failure rate indicate that many managers need competent advice before starting their new business.

The paper is mainly concerned with the accounting needs of small firms which have been in business for at least a year or more since these are the firms which generally employ a local practitioner. However, many of these firms are not operating in an efficient manner. As was cited previously only two out of five businesses which survive for eighteen months will also be in existence ten years after

¹Paul W. Paustian and John E. Lewis, Jr., Small Business Instability and Failure in Alabama (University, Alabama: The University of Alabama, 1963), p. 52.

inception. At the same time recent statistics indicate that a successful history is no guarantee of future success. Almost twenty-five per cent of business failures in 1968 were firms which had been in existence for more than ten years.¹ Included in this listing was a Louisiana building contractor who had previously survived a depression, several recessions, and several wars since the start of his business in 1933. The large percentage of failures in well-established, small firms indicates that these firms may have major deficiencies which need to be corrected in order to insure that most small firms operate in an efficient and economical manner.

Failures are not solely restricted to the firm which has few employees and a small amount of assets. A review of recent bankruptcy filings indicate that some of the unsuccessful firms are quite large in size. An electronic firm, for example, employed several hundred employees and a textile company had assets of more than one million dollars.²

Competition from giant corporations does not appear to be a significant factor in the failure of small firms. A detailed study of ten bankrupt small metal manufacturing companies as contrasted with ten successful companies in the

¹Rowena Wyant, "Business Failures," Dun's Review, January, 1969, p. 85.

²"Business Counts the Casualties," Business Week, February 7, 1970, p. 27.

same field found that generally larger competitors are not the cause of failure.¹ The study further found situations where small firms succeeded under conditions similar to those conditions of other small firms that had failed.

Lack of use of accounting data is a major cause of failure.--The evidence indicates that the overwhelming majority of small business failures are due to uninformed management decisions. The uninformed management decisions are generally due to a complex set of interacting factors which result in an unbalanced attention to the functions of management. Dun and Bradstreet, Inc. annually analyzes business failures in order to determine the major causes of these failures. This continuous study has found over the years that the principal cause of failure has been a lack of balanced management training and experience, or a lack of sufficient time given to all the functions of management. In 1968, for example, approximately ninety per cent of all failures were due to uninformed management decisions.² More specifically the failures were due to a combination of factors such as the following: (1) poor sales policies, (2) excessive investment in plant and equipment, (3) poor inventory policies, (4) excessive operating expenses, (5) failure to engage in a long range planning, (6) poor credit poli-

¹A. M. Woodruff and T. G. Alexander, Success and Failure in Small Manufacturing (Pittsburgh: University of Pittsburgh Press, 1958), p. 117.

²Rowena Wyant, "Business Failures," Dun's Review, March, 1969, p. 115.

cies, (7) inadequate records, and (8) failure to use accounting data in internal operations.

The previously mentioned study of both successful and unsuccessful small metal manufacturing companies found that weakness in no one function of management was the sole cause of bankruptcy, but that bankruptcy was due to a combination of management errors. On the other hand, the study did find that "inadequate or misleading financial records probably caused more trouble than any other error of management."¹ The study further found that none of the ten unsuccessful firms had adequate records, while nine of the firms had extremely poor records. The successful firms, on the other hand, kept sufficient records and also made full use of the records. The successful firms' internal information system for planning, control, and decision making purposes provided management continuously with timely, accurate, and pertinent data which was used by management in their decision making process.

The study also found that generally the basic causes of failure were at work for months or even years before the firms eventually succumbed to these deficiencies. A careful analysis of pertinent accounting data, along with an annual appraisal of a firm's internal information system would have disclosed the deficiency in time to take corrective action.

¹Woodruff and Alexander, Success and Failure in Small Manufacturing, p. 119.

10

The strongest deficiency resulting in uninformed management decisions in small firms appears to be due to the failure of the accounting system to supply pertinent information for decision making purposes. The lack of, or failure to use, adequate accounting data in decision making functions has long been recognized as one of the main reasons why many small businesses do not operate as efficiently as possible, and, also, one of the major causes of small business failures. A Department of Commerce survey of small retail firms in 1933 found that most of the profitable firms in the survey kept simple and adequate records while most of the unprofitable firms kept poor records.¹ The survey concluded that poor accounting practices were a major factor in the unsuccessful operation of a small business.

More recent surveys of small firms have found that the failure to use accounting data to furnish relevant data for decision making is one of the major causes, if not the most important cause, of small firms failing to operate efficiently. A survey of small retail stores by the University of Wyoming found that the failure to use accounting data "may well be the most important problem of small business in Wyoming."² Another study of small enterprises by Arizona

¹U. S., Department of Commerce, Small Business Problems, by Charles H. Welch and Charles H. Sevin (Washington, D. C.: Government Printing Office, 1945), p. 2.

²John L. McKeever, A Study of the Problems of Small Retailers in Wyoming (Laramie: University of Wyoming, 1960), p. 2.

State University concluded that "inadequate accounting records materially limit the success of small firms."¹ Finally, a survey by the Bureau of Business and Economic Research at Northeastern University found that "there is a close relationship between sound accounting practices and profitability."²

An adequate accounting system will not automatically guarantee success, but timely information provided by such a system will enable management to make decisions with the aid of pertinent data rather than on the basis of hunch and intuition. A decision by management tends to be on the average no better than the information supporting that decision. Thus, the accounting process of the average small firm needs to be improved.

A recent study by Robert R. Nathan Associates under contract with the Small Business Administration projected the outlook for small businesses in the early 1970's. The study concluded that the growth rate of small business firms will be only about two-thirds as fast as the rate of growth in the 1960's.³ The study further determined that most of

¹William S. Peters, Patterns of Success for Selected Small Business in Arizona (Tempe: Arizona State University, 1962), p. 19.

²Alvert Slavin and Seith Avakian Armen, Small Business Accounting in Massachusetts-Practices and Problems (Boston: Northeastern University, 1962), p. 12.

³Edward D. Hollander, The Future of Small Business (New York: Frederick A. Praeger, Inc., 1967), p. 195.

the new small businesses will continue to have a short existence, while most of the survivors will attain a modest and stable success. However, many of the small firms of the future will have to compete against large corporations which will tend to have very sophisticated internal information systems. The future of the typical small business will tend to be determined by the quality of decisions made by the small businessman which will be greatly affected by the adequacy of the internal information system.

Profile of Typical Accounting System

Accounting systems tend to be oriented to furnishing external reports and providing financial control.--Studies of the accounting systems of small businesses indicate that many accounting systems are oriented to achieving the twin goals of furnishing external statements and to a lesser extent providing financial control. A study conducted by Western Reserve University found that financial statements are prepared mainly for use in securing bank loans and for federal and state income tax purposes.¹ The study continued by indicating that accounting tends to play a minor role in the operation of many small businesses. A study of small manufacturing firms by the University of Washington found that relatively few of the small businessmen actually uti-

¹Kenneth Lawyer, Small Business Success: Operating and Executive Characteristics (Cleveland: Western Reserve University, 1963), p. 70.

lize their accounting records as a managerial tool.¹ The study also indicates that the accounting system of many small firms serves no other purpose than to satisfy loan requirements, provide financial control, and to satisfy federal income tax regulations. However, with little additional cost, the accounting system can generally be designed to supply relevant data for decision making purposes rather than being treated as a necessary evil.

The results of the above cited studies help to explain why so many long established firms become failures in prosperous times. With many small businesses having accounting systems designed solely to satisfy external requirements, management receives no useful information pertaining to the internal operations of the firm. Thus, management of many small firms tends to make decisions on the basis of experience, hunch, and intuition rather than on the basis of pertinent data.

An accounting system can be designed to accomplish various purposes. An established small firm would tend to have at least an accounting system which would correctly reflect net income in order to satisfy federal and state income tax regulations. A small business may further install a system which provides for financial control and a local practitioner may be asked to render an opinion on the finan-

¹Joseph W. McGuire, Factors Affecting the Growth of Manufacturing Firms (Seattle: University of Washington, 1963), p. 58.

cial statements in order to satisfy requirements such as a loan application. Finally, small proprietors could design their accounting system for the purpose of gathering relevant data to be used in the actual operation of the business. This accounting information system could be designed to gather data in such a manner as to indicate how well the company is achieving its objectives and the effect of various decisions on these objectives. In order to obtain the optimum value of an accounting system it should be designed to gather relevant data for decision making purposes and provide for operational control. The information gathered by such a system must be communicated to management in a form in which it can be utilized and comprehended.

The main problem of small firms pertaining to accounting data is usually not the function of record keeping. However, the failure to keep records still exists in a very few small firms. The study of small manufacturing firms by the University of Washington found that approximately five per cent of the firms in the sample did not keep accounting records of some form.¹ Another study of small businesses by George Washington University did find some instances of poor record keeping practices in bankrupt firms as some firm's records were so poor that court appointed accountants could not complete their audit.² Nevertheless, the major defi-

¹Ibid., p. 57.

²Janet M. Pomeranz and Leonard W. Prestwich, Meeting the Problems of Very Small Enterprises (Washington, D. C.: George Washington University, 1962), p. 140.

ciency in the accounting function is the failure to design the accounting system to gather pertinent data pertaining to internal operations and/or the failure to use the data which has been gathered by an adequate accounting system rather than the failure to keep accurate records.

A study of the larger small manufacturers located in the state of North Dakota found that information and data-gathering "systems in use are, for the most part, poorly planned and do not yield the required and important information that a manager needs if he is to make the proper decisions about the conduct of the business."¹ The study further concluded that all of the firms included in the sample had the capability required to gather such data and if the data were gathered it would materially assist managers in the decision making process. Another study was made by the University of Michigan which included a detailed analysis of the accounting system of new small manufacturing firms. The study analyzed and evaluated the accounting systems of eighty-two firms including a review of such accounting techniques as financial budgets, forecasts, inventory controls, and costs breakdowns. The study found that only seventeen of the eighty-two firms had a good accounting system, while twenty-seven firms had very poor systems, with the remaining

¹Ludwik Kulas, R. D. Koppenhaver, and Thomas J. Clifford, The Development of Management Information for Small Manufacturers (Grand Forks: University of North Dakota, 1965), p. 37.

firms rated in the fair and poor range.¹ These studies indicate that the accounting system is generally not properly designed to produce essential data for internal use.

Since firms are forced to maintain records to satisfy federal and state regulations, many small firms could obtain the maximum return from their accounting data by the installation of an adequate accounting system. However, the function of a satisfactory accounting system is not complete until the results have been correctly interpreted and presented to management in a form in which it can be understood and utilized. Small business studies indicate that an acute problem is to be found in the area of interpretation. One study found that the records of many small firms were kept in a very precise manner, but the information was not transmitted to, or used by, management.² Another small business study found that relatively few small businessmen actually utilize existing accounting data as a managerial tool to assist them in guiding the firm.³

Small firms tend to overlook the value of an adequate accounting system.--Evidence previously mentioned in-

¹William M. Hood and Peter Rasko, Management Factors Contributing to the Success or Failure of New Small Manufacturers (Ann Arbor: University of Michigan, 1964), p. 75.

²N. H. Ringstrom, Case Studies in Business Success and Failure (Stillwater: Oklahoma State University, 1962), pp. 4-5.

³McGuire, Factors Affecting the Growth of Manufacturing Firms, p. 58.

dicates that many small firms are failing to take advantage of the many benefits offered by an adequate accounting system. An adequate accounting system provides essential information pertaining to various internal operating decisions such as the following: (1) optimum inventory levels, (2) productivity of assets, (3) whether or not to keep, promote, or eliminate a product, (4) whether to make or buy, and (5) searching methods to choose the best alternatives which will most likely accomplish company objectives. Naturally, many small firms are not obtaining this vital information, but they are generally incurring significant costs in maintaining an unsatisfactory accounting system which produces information of little value for internal use. On the other hand, some small businesses have an accounting system which provides ample information, but the information is never utilized by management. Therefore, many small firms appear to be operating at less than optimum efficiency due to the failure to use the pertinent information provided by their accounting system or due to the failure to design their system to provide pertinent information. Accounting will probably continue to remain a major problem of small businesses as they continue to make decisions solely on the basis of prior experience and intuition. Prior experience may tend to give management acceptable answers in a stable period, but in our dynamic and complex economy past experience tends to cause many erroneous decisions. Reliance on

prior experience tends to cause decision makers to overlook alternatives.

The foundation of an adequate accounting information system is the gathering of accurate data. The accounting system should be further designed to gather relevant, material, and timely data for internal use in accordance with the specific needs of the company besides performing the traditional function of providing financial control and producing financial statements to outsiders. The accounting system for internal information can be further subdivided into providing and analyzing data for recurring and nonrecurring decisions. The data provided to management should indicate how a decision will effect the company's overall objectives.

The exact composition of a sufficient accounting system for a small business will depend on the particular needs of each individual firm. A relatively large small manufacturer, for example, would need a much more elaborate cost accounting system than would a small used car dealer. On the whole, management accounting techniques in varying degrees are applicable to all small businesses.

Accounting techniques appropriate for internal use generally require that costs be separated into their fixed and variable components. Many of these techniques make it necessary to recognize relevant costs including opportunity costs and future costs. The study of the uses of accounting in small business decisions found that opportunity costs and incremental costs are rarely used in situations where they

are relevant.¹ The study found that, for example, few nurseries make use of opportunity cost. Most small retailers have never heard of incremental methods. The study further found that nursery accounting literature has a bias toward full cost.

Direct costing, merchandise management accounting, and other similar accounting techniques serve multiple purposes. Many times these techniques will not supply all of the relevant data needed for nonrecurring decisions. Capital budgeting and operations research techniques, such as linear programming, are examples of methods available for use in the appropriate situation in the nonrecurring decision area.

Although capital budgeting and operations research techniques are very valuable management tools, they appear to be too sophisticated to be used in the correct manner by the typical small firm. The previously mentioned study of the uses of accounting data in small business decisions found that modern quantitative techniques are not feasible for most small businesses due to such factors as lack of required skills.² However, these modern quantitative techniques can be used advantageously by the small firm. A study of the uses of operations research in small businesses

¹James L. Gibson and W. Warren Haynes, Accounting in Small Business Decisions (Lexington: University of Kentucky Press, 1963), pp. 30-54.

²Ibid., p. 125.

by the University of Iowa concluded that operations research tools were valuable and not prohibitively costly for use by the small firm.¹ At the same time, the study determined that certain operations research techniques are more applicable to small businesses than are others. The effective use of this technique is dependent upon the availability of accurate and timely relevant accounting data along with adequately trained personnel.

Information provided by a typical small business accounting system tends to be inadequate.--The profile of a typical accounting system of a small firm as compared to the requirements of an accurate accounting system is illustrated in Figure 1. The darker areas indicate that the system generally satisfies some particular parts of the requirements of an adequate system. As is noted, the accounting system typically furnishes external reports and provides financial control and partially provides accurate data. On the other hand, the system generally does not provide information for internal decision making purposes nor does it present this data to management in a form in which it can be understood. The accounting system of a typical small business has not changed significantly since firms were first required to keep records by the passage of the federal income tax law in 1913.

¹Bob R. Holdren, Albert Buckberg, and N. Paul Loomba, Operations Research in Small Business: A Case Study and Primer of Operations Research Techniques (Iowa City: University of Iowa, 1963), pp. 54-55.

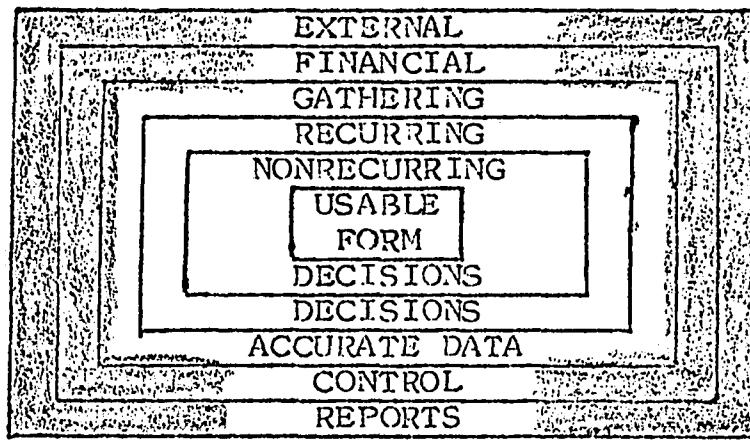


FIGURE 1

ILLUSTRATION OF THE EXTENT
TO WHICH A TYPICAL ACCOUNTING SYSTEM
OF A SMALL BUSINESS SATISFIES THE REQUIREMENTS
OF AN ADEQUATE ACCOUNTING SYSTEM

In contrast, the large corporations have not been satisfied with the traditional accounting system as have their smaller competitors. Although the large corporations have not achieved a total information system, their accounting systems do provide management with relevant data for internal decisions. A major retail chain store is now testing on a pilot basis remote real time computer input units which are attached to cash registers. The input unit accepts the customer's credit card and prepunched miniature input cards pertaining to each article purchased. This act makes immediately available to the large corporation such information as sales trends and inventory levels. Much of this information many small retailers only know yearly. The system provides pertinent information which many small retailers never know. Modern large corporations use many other modern quantitative techniques in the operation of

20

their businesses. In the future many managers of small business will be forced to obtain more accurate information for internal use in order to compete with the larger firms.

Use of Selected Accounting Techniques

Ratio analysis is a relatively simple accounting technique.--In order to demonstrate the value to small businesses of accounting techniques, two such techniques have been selected for a more detailed investigation. One selected method is relatively simple and is named ratio analysis. The other selected technique is more complex and is named planning.

Ratio analysis is an inexpensive analytical tool. The decisions of management are reflected in the income statement, balance sheet, and funds statement. Ratios are applied directly to these financial statements. The ratios that are derived from financial statements will help to point out the strong and weak points of a firm. The proper use of ratio analysis will tend to enable a businessman to make a more effective use of his assets and to operate his company on a sounder financial basis. Small firms which do not have a complex organization are particularly suitable for the benefits available from the use of this powerful tool for the purpose of internal analysis.

The use of ratio analysis in the interpretation of financial statements is a comparatively recent development. Euclid had a rigorous analysis of the properties of ratios

in Book V of his Elements in about 300 B. C.¹ However, the analysis of financial statements by the means of ratio analysis probably dates back to the 1890's, and the first ratio to be used was the current ratio.² The analysis of financial statements became much more sophisticated with the passage of time.

One should select with care those ratios which are appropriate in analyzing a particular company. Further recognized is the fact that ratios must be used carefully since such factors as the use of a particular accounting method can have a significant effect on certain ratios. However, this simple tool when used prudently can be a very inexpensive and powerful management tool.

There are two general approaches to ratio analysis and the results of these two approaches are generally combined in the final analysis of a firm. One general approach is the common-size or vertical analysis which indicates the relationships among items comprising a particular statement. The other approach is the trend or horizontal analysis which measures trends in items between successive or comparative financial statements. Ratios must be computed in a timely manner, be completely understood by management, and be based

¹James O. Horrigan, "A Short History of Financial Ratio Analysis," The Accounting Review, XLIII (April, 1968), 284.

²Roy A. Foulke, Practical Financial Statement Analysis (5th ed.; New York: McGraw-Hill Book Company, 1961), pp. 181-191.

on accurate accounting data in order to be an effective management tool.

Ratios should further be compared in a timely manner with ratios of prior periods, budgeted ratios, and with ratios of similar companies. The comparison of prior periods and budgeted ratios will help a small businessman to determine whether or not an unfavorable trend has developed. For example, a lower turnover of finished goods inventory as compared to prior years and budgeted estimates may indicate an excessive investment in inventory. A more detailed analysis of the accounting data may reveal that the cause of the lower turnover rate is due to an over-production of inventory or it may be due to obsolete or slow moving inventory. Whatever the cause, the use of adequate and accurate accounting records will reveal the cause of the deficiency which has lowered net income, and management can take quick corrective action.

When ratios are compared with the average industry ratio of similar sized firms, a businessman can determine how efficiently he is operating his firm as compared with the average firm of similar size. Analysis will not point out the specific cause of the trouble, but will indicate to management that further analysis is needed. With this type of analysis, a businessman can take speedy corrective action to prevent further inefficiencies or to take advantage of efficient operations. Ratios also enable a small businessman to determine promptly information such as the following:

(1) if receivables are being collected in the normal length of time, (2) if a tendency exists toward over-investment in fixed assets, (3) if return on capital is improving, (4) if working capital position is improving, and (5) if return on assets is improving. Without the use of ratio analysis, the development of trends in the operation of a firm would probably have not been discovered in a prompt manner in order to take quick appropriate action.

Ratios are a sensitive predictor of failure.--Information pertaining to the predictive ability of an accounting tool is a very valuable aid in the selection of accounting data for decision making purposes. Recent studies indicate that certain selective ratios are sensitive predictors of failure of firms. A study by William H. Beaver of both successful and unsuccessful firms during the period from 1954 to 1964 found that certain selected ratios are significant predictors of failure for a period of time as long as five years in advance of failure.¹ Furthermore, the results of the study were proven to be statistically significant.

Additional research by Dr. Beaver indicates that certain ratios have much greater predictive power than others. The study indicates selected nonliquid assets are better predictors of failure than liquid ratios in all five

¹William H. Beaver, "Financial Ratios as Predictors of Failure," Empirical Research in Accounting: Selected Studies, 1966 (Chicago: University of Chicago, 1967), pp. 71-111.

years before failure, and that the cash flow and net income ratios had a better predictive power than all of the eleven selected liquid asset ratios in all five years before failure.¹ The study points out that one must be selective in the choice of alternative accounting methods.

A more sophisticated and accurate predictor of failure can be calculated by the means of statistical discriminant analysis. This technique assigns a relative weight to each relevant ratio which assumes that certain ratios are more sensitive predictors than others. Statistical discriminant analysis was used to predict the financial conditions of savings and loan associations in the state of California for the year 1965. The study found that this technique identified three years in advance weaker associations which did have serious financial difficulties although these firms had been considered to be sound by authorities at that time.² However, the technique must be used with care since the relative weights of each ratio can change due to the changes in the environment. Thus, the technique must be updated periodically in order to be an effective tool. Statistical discriminant analysis is just one example of the many modern quantitative techniques which are being used

¹William H. Beaver, "Alternative Accounting Measures As Predictors of Failure," The Accounting Review, XLIII (January, 1968), 117.

²Gerald Winston, "Early Warning System For Business Managers," Management Services, VI (May-June, 1969), 31.

with judgment by progressive accountants in order to provide their clients with more suitable data for internal use.

The studies of the predictive power of ratios to indicate the probable failure of a firm is a very significant finding as far as a management of a small firm is concerned. Since approximately only one small firm in five will survive through the first ten years, the ability of selected ratios to predict possible failure, points out that this analytical tool is certainly worth the relatively little time and effort required in the application of its simpler techniques. The studies cited point out that firms should use a carefully selected group of ratios in order to obtain the maximum benefit of this valuable and relatively inexpensive tool. Of course, the tool should be used only by someone familiar with its applications.

Ratio analysis enables a firm to operate more profitably.--Ratio analysis not only is a significant predictor of failure, but conversely it generally enables a firm to operate more efficiently when it is used as an aid in the decision-making functions. A study by the Bureau of Business and Economic Research at Northeastern University concluded that a strong relationship can be found between overall success of a company and the use of ratio analysis. The study divided the firms included in the survey into the following four categories: (1) highly successful, (2) moderately successful, (3) fair (getting by), and (4) unsuccessful.

ful (not likely to survive). The results of the study found that ninety-five per cent of the firms rated in the most profitable category used ratio analysis while more than seventy-five per cent of the firms rated in one of the two profitable categories regularly used ratio analysis.¹ Further noted is the fact that most of the unsuccessful firms did not use ratio analysis.

The results of the study lend strong support to the hypothesis that the use of selected accounting data such as ratio analysis as a management tool is directly and positively related to a more efficient, effective, and economical operation. The relationship of the use of ratio analysis and profitability found in the study does not appear to be the result of chance due to the fact that the results were proven to be statistically significant by means of the standard T-test using the five per cent level of significance.

Small firms do not tend to make a comprehensive use of ratio analysis.--Studies sponsored by the Small Business Administration indicate that many smaller business firms are not taking complete advantage of ratio analysis. The studies indicate that this tool is used more frequently by the larger firms as contrasted with the smaller business firms. A study made by Temple University of the larger and better established small businesses in Pennsylvania found that seventy-nine per cent of the firms made some use of ratio

¹Slavin and Armen, Small Business Accounting in Massachusetts-Practices and Problems, p. 18.

analysis.¹ However, the study had a very broad definition of ratio analysis which included keeping informed about some relationship even though the firm was not consciously using ratio analysis as a formal management tool. Another significant finding of the study was that only approximately ten per cent of the firms computed a group of ten selected pertinent ratios.² The fact is indicated that even the larger small businessmen do not make a very comprehensive use of ratio analysis. Indicated earlier was the fact that the most beneficial results of the tool are only available when a comprehensive analysis is made with the aid of a selected group of pertinent ratios. A study of smaller retail firms in Wyoming by the University of Wyoming found approximately sixty-nine per cent of the companies in the sample did not use ratio analysis in their own business, and that approximately eighty per cent of the companies did not use financial ratios to compare operations with similar stores.³ The study confirms the previously cited study which found less evidence of the use of ratio analysis by smaller firms.

The lack of use of ratio analysis by many smaller firms may well be due to the lack of knowledge of the advan-

¹Nathaniel Jackendoff, The Use of Financial Ratios and Other Financial Techniques and Services by Small Business (Philadelphia: Temple University, 1961), p. 23.

²Ibid., p. 24.

³John L. McKeever, A Study of the Problems of Small Retailers in Wyoming (Laramie: University of Wyoming, 1960), p. 21.

tages of this important management tool. Ratio analysis is a very valuable management aid even when a firm is operating at a satisfactory profit level. A firm, for example, may be operating at a satisfactory level and still have a loss in one department. The small business firm, without the benefit of ratio analysis, may expand its weakest department without realizing the effect of such a move. The failure to analyze financial statements may result in inefficiencies of weaker departments not being eliminated. At the same time, the very profitable departments are probably not being exploited.

A study of retail firms by the University of Illinois found that only fourteen per cent of the firms in the sample used all of the five ratios which were selected to be the most pertinent ratios for use by small retail stores.¹ Other studies previously cited indicate that very few small firms obtain the maximum benefit of ratio analysis. Unfortunately some of the firms which compute a comprehensive group of selected ratios do not appear to use the ratios in their decision making process. A survey of the use of accounting in small business decisions found that in larger retail stores a great deal of time and effort is spent in computing and recording ratios.² However, the study further

¹Elizabeth Y. Deran, The Successful Shopkeeper: A Study of Retailer Survival in Nine Communities (Urbana: University of Illinois, 1963), p. 31.

²Gibson and Haynes, Accounting in Small Business Decisions, p. 44.

found that the effort spent is not always a good indicator of the use of the data because in some cases management never utilized the information.

Many of the advantages of ratio analysis are not being utilized by small firms.--Comparing a firm's ratios with the average ratios of similar sized firms in the same industry will tend to indicate how efficiently the firm is being operated as contrasted to the average firm. This type of analysis can aid in pointing out areas where there is a high probability that improvements could be made. A study of selected successful small firms in Arizona computed average ratios by industry for these small firms and compared the ratios with national industry ratios for similar firms. A comparison, for example, of ratios for the independent retail stores in Arizona found that they hired more employees per store than the average national store, and also that the sales per employee were substantially lower than the average national store.¹ Further investigation revealed that the unfavorable relationship was apparently due to the inefficient use of store personnel rather than due to a significant difference in store size. The study indicates some of the advantages available from the comparison of a firm's ratios with average industry ratio.

¹William S. Peters, Patterns of Success for Selected Small Businesses in Arizona, p. 16.

The comparison of ratios with average ratios may result in misleading information if the comparison is made by someone who is not familiar with the computation of the average ratio. A study of published industry ratios found that some ratios disagree widely as to the direction and rate of change in industry ratios from year to year.¹ The study found that many compilers of industry ratios have difficulties in obtaining complete and comparable data from participating firms. The study indicates that although ratio analysis is a fairly simple tool it should be used by someone familiar with basic accounting relationships in order to obtain accurate and adequate results. The analyzer should also be familiar with the various sources of industry ratios in order to select one which is comparable with the firms accounting data.

Planning is a most valuable accounting technique.--

Planning is a very valuable accounting tool, but it is more complex than ratio analysis. The thought has been expressed that "though planning does not insure profits, it comes closer to that goal than any business management method yet devised."² As important as planning is, surveys of small

¹Nathaniel Jackendoff, A Study of Published Industry Financial and Operating Ratios (Philadelphia: Temple University, 1962), p. xii.

²Delbert C. Hastings, The Place of Forecasting in Basic Planning for Small Business (Minneapolis: University of Minnesota, 1961), p. 9.

businesses have found that only a very limited number of smaller companies engage in some form of formal planning. The study of small retail businesses by the University of Wyoming found that ninety-one per cent of the firms in their survey did not use forecasting.¹ A survey in Minnesota concluded that "forecasting was especially infrequent among the very small firms."² Furthermore, one survey of small businesses concluded that lack of long-range planning is one of four weak points common to most small businesses located in the Western states.³ The study further indicated that many managers do not tend to make long-range decisions except under conditions of duress or by conditions of default. These conditions of necessity certainly do not tend to result in optimum long-range decisions.

An accurate forecast is important to a firm because it supplies the basic data for budgeting. With the aid of computer facilities, forecasting for many firms has been greatly simplified with the aid of such preprogrammed statistical tools as multiple regression. A local practitioner with the aid of a remote computer terminal facility which has access to modern statistical programs could forecast

¹McKeever, A Study of the Problems of Small Retailers in Wyoming, p. 28.

²Hastings, The Place of Forecasting in Basic Planning for Small Business, p. 11.

³John B. Kline and John T. Douth, Case Problems of Small Businesses in the Rocky Mountain West (Boulder: University of Colorado, 1961), p. 3.

sales in a very short period of time. Other small firms actually have data available for forecasting and with slight changes in their accounting system could perform accurate forecasts, especially for items with fairly stable demand curves. The survey of the uses of accounting in small firms found that retail stores generally could prepare fairly adequate forecasts with only slight changes in their accounting systems.¹

Budgeting tends to be used more often by larger small businesses.--Although budgeting is more frequently used by the larger small businesses, often the need for this tool is at least as great in the smaller business. An important value of budgeting lies in the fact that management must put their objectives down on paper, and these objectives must be converted into dollars and cents. This method of considering the best way to achieve objectives in an unbiased manner leads to the process of searching for alternatives. Many times management finds that selected objectives will not be reached unless they take corrective action to eliminate certain inefficiencies or select an alternative way of achieving the objectives. Budgeting is also used to measure performance, to control costs, and is usually an aid in obtaining loans.

¹Gibson and Haynes, Accounting in Small Business Decisions, p. 54.

Probably the most important attribute of budgeting is that it tends to enable a small firm to operate more profitably. A study by Northeastern University indicated that "the more profitable and successful firms utilized the accounting techniques of budgeting and forecasting more often than those which were only moderately profitable or barely able to survive."¹ The study points out that many small businesses in very competitive markets are able to survive only by using budgets. The management of a small firm with the aid of a competent advisor should design the budgets according to the needs of that particular firm. Budgets are most effective when they are compared in a timely manner with actual results. The variances outside of the tolerance limits should be analyzed and any required action may be taken in a prompt manner. It should further be determined whether or not a specific budget will justify its cost.

The lack of budgeting by small businessmen may be due to the fact that they believe they are so close to their company that the added cost of budgeting is not justified. Generally some additional cost is associated with the installation of budgets, and the estimation has been made that "a complete budgetary system would increase the

¹Slavin and Armen, Small Business Accounting in Massachusetts: Practices and Problems, p. 48.

accounting costs by ten per cent."¹ A complete budgetary system for the purpose of this estimate included an operating budget, a cash budget, a capital budget, and a forecast of financial position. Of course, the actual cost of a budgetary system will depend on the particular operations and requirements of each firm.

Most businesses will no doubt find that the added costs of a complete budgetary system will be recovered many times through efficient operations. A study of budgeting practices in small department stores by the University of Arkansas recommended specific accounting procedures for stores which had previously not engaged in budgeting. A follow up study one year afterwards found that the suggested budgeting procedures had been very successful. One store had changed the space allocated to each department with the result of increasing sales and profits and another store had reduced its inventory for the first time in the store's history. The reduction had resulted in higher profits.² The study is another example of the advantages of an adequate accounting system. The management of these small firms had not recognized the advantages of such a system until they were pointed out by competent outside specialists.

One indication of the need for a form of budgeting is reflected in the causes of business failures for the year

¹Wayne Keller, "Budgeting for Small Business," The Journal of Accountancy, CV (January, 1959), 45.

²Robert W. Bell, Business Budgeting for Small Department Stores (Fayetteville: University of Arkansas, 1963), p. 3.

1968. Approximately five per cent of the business failures in 1968 were due to excessive investment in fixed assets. The cause was especially prominent in the manufacturing and commercial services industries where approximately six per cent and eight per cent of the causes of failures respectively were due to over-investment in fixed assets.¹ The use of the managerial accounting technique of capital budgeting would have probably prevented much of the major problem of over-investment in fixed assets. However, a study of investment decisions by small firms found that most small businesses placed relatively little emphasis on investment planning.² Capital budgeting is a valuable technique, but it is more sophisticated than some accounting techniques such as ratio analysis. Besides being a fairly sophisticated accounting tool, capital budgeting requires a knowledge of federal and state income tax laws. The average small proprietor or his bookkeeper probably do not possess the necessary skills to apply this technique successfully. As a rule the technique would have to be applied by an outside advisor such as a local practitioner.

¹Wyant, "Business Failures," March, 1969, p. 115.

²Martin B. Solomon, Jr., Investment Decisions in Small Business (Lexington: University of Kentucky Press, 1963), p. 4.

Need for Outside Advisors

Lack of accounting skills tends to limit the usefulness of accounting.--One reason that firms do not use the sophisticated techniques is that their accounting systems are not designed to gather relevant data or the data gathered is not accurate. The study of small manufacturers by the University of North Dakota, for example, concluded that often poor planning is the result of inadequate records.¹ The study further concluded that the absence of adequate records can often spell disaster and that several firms studied in the period ceased operations or were in precarious positions due to poor planning.

However, an analysis of retail stores in Oklahoma found that one of the major causes of failure to use analytical accounting tools such as ratio analysis in an optimum manner was due to the lack of knowing how to analyze.² While ratio analysis is a relative simple accounting tool, it does require a basic understanding of accounting principles.

The evidence indicates that small business management and its bookkeepers generally do not possess a basic knowledge of accounting. A survey of the larger small busi-

¹Kulas, Koppenhaver, and Clifford, The Development of Management Information for Small Manufacturers, p. 37.

²Homer A. Brown, Jr. and Alva A. Cummings, Accounting and Financial Data for Retail Stores: Primary Purposes and Uses (Norman: University of Oklahoma, 1964), p. 8.

ness enterprises in Pennsylvania found that approximately forty per cent of the managers and thirty-five per cent of the full time bookkeepers have never had a formal course in either accounting or finance.¹ The study further concluded that many of the personnel who have had a course in finance or accounting have not had an advanced course in either area. The survey also found that approximately sixty per cent of the part time bookkeeping help had not had a course in either accounting or finance.²

Doubtlessly, a manager with a weak accounting knowledge will tend to overlook the value of an adequate accounting system. The lack of knowledge of accounting tends to result in an accounting system designed to provide only financial control and reports to outsiders or an accounting system which yields valuable data which is not used by management as a guide in formulating decisions. Based on the present accounting knowledge of an average small businessman, the only way out of the predicament of lack of pertinent information or guidance in decision making appears to be for competent outsiders to provide the missing link of expert accounting knowledge and interpretation. Management accounting techniques such as direct costing might even do more harm than good for the average small business firm

¹Nathaniel Jackendoff, The Use of Financial Ratios and Other Financial Techniques and Services by Small Business, pp. 42-43.

²Ibid., p. 52.

based on the present state of knowledge. Direct costing, for example, is a powerful accounting technique, but it must be used by someone who is familiar with the technique. Direct costing could lead to underpricing if the direct costing reports were interpreted by unqualified personnel. As long as the condition of lack of essential information continues many small businesses will probably continue to operate in an inefficient manner.

The manager of a small firm must generally make operating decisions without the aid of outsiders.--The weight of the evidence gleaned from studies of small business indicates that the major problem of small businesses is the failure of management to be a "Jack of all trades." The studies indicate that the management of small firms needs competent outside advice especially in the area of accounting information in order to successfully compete in the present day complex economy. Many times a small proprietor will have a superior talent in one area of management, but will tend to overlook other essential areas of management. A manufacturer, for example, may have a sales background, and he may be an exceptional salesman. A retailer may have a rare talent in another area such as being a designer of jewelry. An exceptional salesman or a talented designer of rare jewelry would probably tend to devote most of his time to his specific interest and be prone to overlook the other areas of management such as accounting,

which may tend to be considered as a necessary evil.

A small business requires its manager to have a balanced knowledge of all the major functions of a business and he must also have sufficient time to give attention to all phases of management. A study of the largest small manufacturers in North Dakota by the University of North Dakota found that the decisions pertaining to the operation of the firms were made by the manager and only in a very few cases did the manager have the assistance of staff specialists.¹ The study further concluded that the firms only rarely conferred with outside management consultants, and boards of directors generally offered no advice. The evidence indicates that the manager of a typical small business is entirely responsible for the operating decisions of the firm. Thus, the small proprietor must be a "Jack of all trades" in order to operate his business in an efficient manner. The typical small business manager must be to his business what the combined forces of staff specialists, internal audit department, the treasurer, the director of information, the controller, outside consultants, the president, and the board of directors are to a large business. Furthermore, the small proprietor must be an able administrator because he has little room for error. One major wrong decision may even cause bankruptcy. For example, an

¹Kulas, Koppenhaver, and Clifford, The Development of Management Information for Small Manufacturers, p. 8.

unsuccessful opening of a branch store could be disastrous for a small retail firm, where as this same decision would probably have no significant effect on a large chain department store. It is no wonder that there are so many small business failures due to the various talents which are demanded of the manager in order to operate in an efficient and economical manner.

The average small businessman needs competent outside advice.--The typical small business needs competent help to locate and correct the problem areas of the business, and advise how the firm can best obtain its objectives. A small businessman cannot afford to employ on a full time basis the variety of specialists a large business has on its permanent payroll. Nevertheless, the small firm needs these skills even if they are only on a part time basis. There appears to be little doubt that most small businesses have a large number of problems which can only be satisfactorily solved by a capable outside management consultant. One study of small firms did find that more than ninety per cent of the firms included in the sample stated that they had been challenged by some type of problem in the operation of the firm.¹ Of course, the total does not include the actual problems which were not recognized by the proprietor.

¹Pomeranz and Prestivich, Meeting the Problems of Very Small Enterprises, pp. 45-46.

A management consultant has been defined as "one who has a thorough grasp of the principles of business organization and administration."¹ The advisory services of a management consultant are available in many diversified areas including operations research, marketing, accounting and finance, general management, personnel administration, and industrial engineering. Various individuals, partnerships, and companies who perform management services including the Certified Public Accountant are available. Since the failure to maintain adequate accounting records and lack of analysis of accounting data is a major problem of small firms, the local practitioner is in an excellent position to be a very valuable management consultant. The local practitioner could point out any deficiencies in the information system for planning, controlling, and decision making in a timely manner and refer the firm to competent specialists if the local practitioner is not competent in the area and/or if a possible ethical conflict is noted.

A study of management counseling in small manufacturing companies by the University of Mississippi concluded that the greatest need of the small firms was found to be a thorough analysis and scrutiny of the firm's total situa-

¹Preston P. Lebreton, A Guide for Proper Management Planning for Small Business (Baton Rouge: Louisiana State University Press, 1963), p. 126.

tion.¹ The local practitioner would be in a unique position to perform an analysis of the information system in the course of the annual audit. The local practitioner can usually perform management services cheaper than other management consultants due to the continuing auditing relationship with the small firm. A survey of small business consultants by the Bureau of Economic and Business Research of the University of Utah found that "the accountant's knowledge enables him to make worthwhile suggestions in a minimum cost."² The study concluded that progressive accountants are usually very effective as small business counselors.

Summary of Chapter

A brief review of the chapter.--The purpose of this chapter was to analyze and evaluate the accounting needs of a typical small enterprise. The evidence indicated that small businesses play a vital role in the economy. However, many small businesses failed each year and many others did not operate in an efficient manner. The major deficiency of small firms appeared to be uninformed management decisions which resulted from the failure to use adequate accounting data in the decision making process. Research

¹William E. Green, R. Selby Downer, and Joseph Cerny, Case Studies in Management Counseling of Small Manufacturers (University, Miss.: University of Mississippi, 1963), p. 160.

²Grant H. Calder, Small Business Counseling: An Evaluation of Techniques (Salt Lake City: The University of Utah), p. 29.

studies sponsored by the Small Business Administration indicated that many accounting systems were not designed to produce relevant data for internal use. The inference seemed to be that major deficiencies in the internal information system for planning, controlling, and decision making materially limited the success of a small business. The failure of the accounting system to produce relevant data was generally due to the small firms personnel's lack of possession of a basic accounting knowledge. The evidence indicated that most small firms will continue to suffer from lack of relevant data until some competent outsider provides the skills of the controller and his staff of specialists.

Conclusions of the chapter.--After critical evaluation of the various studies of the small business environment and other pertinent data, certain conclusions were drawn. The conclusions seemed to organize themselves into sections. Some conclusions were drawn which were involved with the role and needs of small businesses. Additional conclusions were drawn which pointed out the strengths and weaknesses of the accounting system of small firms. Conclusions were further drawn which demonstrated the use of selected accounting techniques by small firms. Some conclusions were also drawn pertaining to the needs in small businesses for local practitioners to perform management services work. These strengths and weaknesses of small enter-

prises will provide the background material for the study of the role of the local practitioner.

Some conclusions were drawn indicating the role and needs of small businesses. These conclusions indicated that failure to use accounting data was a major problem of most small businesses.

1. Small businesses played an important role in the economy.

2. Many small businesses did not operate in an efficient manner.

3. The failure rate of new small businesses was extremely high as only one out of five firms existed for a period of ten years.

4. Approximately twenty-five percent of all business failures in 1968 were firms which were ten years old or older..

5. The overwhelming majority of small business failures were due to uninformed management decisions.

6. Uninformed management decisions were due to a complex variety of functions which resulted in a breakdown in the decision making information system.

7. The major factor which leads to uninformed management decisions was the failure to use material, timely, and adequate accounting data as an aid in the decision making function.

Additional conclusions drawn pertained to the adequacy of the accounting system of small businesses. The

conclusions indicated that an overwhelming number of small firms kept records, but the accounting system was not generally designed to provide relevant data for internal use.

1. The typical accounting system of small firms was oriented toward furnishing external reports and to a lesser extent providing financial control.

2. The function of record keeping was not the major roadblock in the accounting process.

3. The majority of small firms did not have an accounting system which could be rated adequate.

4. Most accounting systems were poorly planned and did not yield the necessary information required by management to make optimum internal decisions.

5. The typical accounting system did not yield pertinent data for internal recurring and non-recurring decisions.

6. The accounting information was usually not presented to management in a form in which it could be utilized and comprehended.

7. Small businesses tended to rely on full historical costs for decision making purposes although such relevant costs as opportunity costs and future costs were often more appropriate for use in the particular situation.

8. There was an acute problem in most small firms in the interpretation of accounting data.

9. The problem of an inability to interpret accounting data often resulted in the failure of management to utilize this valuable information.

10. The failure to utilize accounting data often led to uninformed management decisions with financial failure and/or inefficiency a probable outcome.

Other conclusions drawn concerned the use of selected accounting techniques by small firms. Some of the small businesses tended to use some form of ratio analysis in the operation of their business.

1. Ratio analysis was a relatively simple accounting technique which all small firms should have used in the operation of their business.

2. Ratios could have been prepared with little additional expense from available financial statements.

3. Selected ratios were proven to be sensitive predictors of the failure of a firm for a period of up to five years in advance of actual failure.

4. Ratio analysis tended to enable a firm to operate more efficiently.

5. Most small firms tended to use some form of ratio analysis.

6. The larger small business made greater use of ratio analysis than did their smaller counterparts.

7. Only a few small businesses attained the complete benefits available from the comprehensive use of ratio analysis.

8. Few small firms compared their ratios with the average industry ratios.

9. Industry ratios had to be used with care since published industry ratios were not always comparable with a particular firm's ratios.

The more sophisticated technique of planning tended to be only rarely used by small businesses.

1. Planning was an important technique associated with an adequate accounting system.

2. Adequate planning tended to result in a more profitable operation.

3. Only a very few small businesses engaged in some form of formal planning.

4. Larger small business firms tended to engage in this technique more often than their smaller counterparts.

5. Smaller small firms tended to have as great or greater need for planning than the larger small businesses.

6. Most small businesses tended to make long range decisions only under conditions of duress or by conditions of default.

7. Accurate forecasts could generally be performed in a short period of time with the aid of computer facilities.

8. Many small firms actually could have prepared forecasts with only slight changes in their accounting systems.

9. Budgeting also tended to be used mostly by the larger small businesses, but the need was often greater in the small firms.

10. Budgets installed with the aid of competent outside advice tended to result in more satisfactory profit levels.

11. Capital budgeting was generally not used by small firms despite the fact that excessive investment in fixed assets was a major cause of failure.

12.. Capital budgeting tended to be too sophisticated for use by the personnel of an average small business.

Some conclusions drawn pertained to the need of most small businesses for competent outside advice. The evidence strongly suggests that the lack of accounting skills on the part of the personnel of small firms tends to materially limit the utilization of accounting data.

1. The failure of small business management to utilize and comprehend the value of an adequate accounting system appeared to be mainly due to the poor accounting background of the managers and bookkeepers of a small firm.

2. The personnel of the typical small business did not possess the necessary skills required in the application of some of the modern techniques associated with an adequate accounting system.

3. The inadequate knowledge of basic accounting techniques could have led to more harm than good if the firm

had attempted to use sophisticated accounting techniques without the aid of outside competent advisors.

4. The average small business would probably continue to suffer from a lack of pertinent information for internal decision making purposes until competent outsiders provided the missing link of expert accounting knowledge and interruption.

Furthermore, the evidence strongly indicated that the local practitioner was in a unique position to provide needed advice.

1. The manager of a small firm must have had a balanced knowledge of all the major functions of a business.

2. Generally the manager of a small business had to make operating decisions without the aid of staff specialists and outside advisors.

3. Most small managers had been challenged by some problem in the operation of their firm.

4. The management of small businesses needed the part time assistance of competent outside advisors.

5. The local practitioner was in an excellent position to be a very valuable consultant since failure to use accounting data was the major problem of most small firms.

6. The small firms greatest need was for a thorough analysis and scrutiny of the firm's total situation.

7. The local practitioner was in a unique position to perform an analysis of the information system for planning, controlling, and decision making.

8. Small business studies indicated that local practitioners who continued to update their knowledge made very effective counselors.

9. The greatest need of a typical small firm was for competent outside advice as to how their information system may have been better designed to provide relevant data in an understandable form for use in the decision making function.

CHAPTER III

AN ANALYSIS AND EVALUATION
OF THE CURRENT SERVICES
PERFORMED BY LOCAL
PRACTITIONERS

Information About Questionnaire

Responses to the questionnaire were favorable.--In order to obtain a profile of the average local practitioner, a questionnaire was developed pertaining to the services offered by sole practitioners and local firms located in the state of Louisiana. The questionnaire was divided into four parts which pertained to referrals, professional development, management services, and other general information.

The directory of members of the Society of Louisiana Certified Public Accountants dated January 1, 1968, was chosen as the official mailing list source since this directory was the latest available comprehensive list of Louisiana practitioners. Eliminated from the mailing list were firms which were known to have offices outside of Louisiana and the employees of these firms, individuals who worked for local firms or industry, and any one else known not to be a full time local practitioner. On May 20, 1969,

questionnaires were sent to 125 sole practitioners and to 98 local firms. Approximately three weeks later a follow-up questionnaire was sent to the same local practitioners except those who had given their names in the written reply to the first questionnaire.

Twenty-three of the 125 individuals included in the sole practitioner mailing list were eliminated from further consideration due to the fact that they or their representative sent information to the effect that the CPA was not a full time local practitioner. The various reasons for elimination from further consideration were death, employment in industry or with a local CPA firm, full time practice as an attorney, sole practice converted into a local firm, retirement or semi-retirement. The adjusted total of sole practitioner list was reduced from 125 to 102 because of the above mentioned information.

Ninety-eight questionnaires were sent to local firms which were thought to have offices confined to the state of Louisiana. Two of these firms were eliminated due to the fact that they sent information which disclosed that the firms had offices outside of Louisiana. However, three firms were added to the list because three sole practitioners had converted their practices into local firms. Thus, the adjusted list of local firms was increased from ninety-eight to ninety-nine firms.

Despite the fact that the comprehensive questionnaire was estimated to have taken from thirty to forty min-

utes to complete, approximately thirty-nine per cent of the respondents completed the questionnaire. In most cases, the questionnaires were completely filled in and many practitioners added pertinent comments in order to clarify their answers or to more fully express their opinions in controversial areas. The response to this questionnaire was very favorable as compared to the results obtained in a recent questionnaire sponsored by the American Institute of Certified Public Accountants. Twenty-eight per cent of the selected membership of the American Institute of Certified Public Accountants completed a common body of knowledge questionnaire including about a twenty-five per cent return from practitioners located in the Southeastern states.¹

The local firms tended to have a more favorable response to the questionnaire than did the sole practitioners. Approximately forty-nine per cent of the local firms completed the questionnaire as compared to approximately twenty-nine per cent of the sole practitioners. Table 1 has presented the responses by geographical region. The geographical region was based on the location of the major office of multi-office firms. In cases where the name was not given, the postmark on the letter was assumed to be the practitioner's principal location.

¹Robert H. Roy and James H. MacNeill, Horizons for a Profession (New York: American Institute of Certified Public Accountants, Inc., 1967), p. 142.

TABLE 1

ANALYSIS OF RESPONSE TO THE MAILING OF
THE LOCAL PRACTITIONER QUESTIONNAIRE
IN THE STATE OF LOUISIANA
BY GEOGRAPHICAL AREA

<u>Geographical Area</u>	<u>Number of Local Firms Responding</u>	<u>Percentage of Replies</u>	<u>Number of Sole Practitioners Responding</u>	<u>Percentage of Replies</u>
Alexandria	2	67	1	50
Baton Rouge	6	37	7	58
Lafayette	4	100	1	33
Lake Charles	4	80	N/A	N/A
Monroe	4	44	1	25
New Orleans	18	45	8	17
Shreveport	7	47	3	14
Other	4	44	9	47
	<hr/> 49	49.5	<hr/> 30	29.4

Note: N/A is an abbreviation for no sole practitioner located in the area.

Furthermore, a short questionnaire pertaining to the areas of referrals, independence, and management services was sent to seven large national firms with offices in the state of Louisiana. Six of these firms completed the questionnaire for a return percentage of approximately eighty-six per cent. The results of the questionnaire will be disclosed in later chapters.

The responses to the questionnaire were stratified.

The fact was recognized that firms of various sizes would tend to possess significantly different characteristics which would make total figures meaningless. In order to present the results of the questionnaire in a more meaningful manner, the answers were stratified according to the total number of professional staff. Professional staff included anyone ranging from a partner to a junior, but did not include clerical help. Table 2 presents the analysis of the responses to the questionnaire by staff size. All of

TABLE 2

ANALYSIS OF RESPONSES TO THE MAILING
OF THE LOCAL PRACTITIONER QUESTIONNAIRE
IN THE STATE OF LOUISIANA
BY PRESENT SIZE OF
PROFESSIONAL STAFF

<u>Total Staff, Ranging from Partner to Junior</u>	<u>Number of Responses</u>	<u>Percentage Distribution</u>	<u>Cumulative Percentage</u>
1 to 5	45	57	57
6 to 10	19	24	81
11 and over	15	19	100
	<hr/> 79		

the sole practitioners have professional staffs of five or less except one which has a professional staff of six. A more detailed breakdown of the staff and age of practice is presented in Appendix B.

General Types of Services

Some noticeable trends in types of services offered are evident.--The purpose of the chapter is to present an overview of selected areas of the common body of knowledge of local practitioners and the general types of services offered by Louisiana local practitioners with particular emphasis on the area of management services.

Some noticeable trends pertain to the general types of services provided by local practitioners. Table 3 indicates that local practitioners are generally experiencing significant increases in the percentage of services rendered in the field of auditing and a steady increase in management services. General tax work appears to be on a fairly level plateau and write-up work tends to be decreasing at a swift pace. Sole practitioners are generally more heavily engaged percentage wise in general tax work and write-up work with local firms engaged more heavily in the auditing and management services areas.

Some of the trends are deceptive.--The trend toward the rapid increase in auditing and the slow but steady increase in management services is somewhat misleading. From the evidence at hand, it appears that the typical local practitioner has a materially different idea of management services than do most authors who have written in this area. The authors generally define the rendering of management services as excluding the functions of auditing, write-up

TABLE 3

GENERAL TYPES OF SERVICES PERFORMED OR EXPECTED TO
BE PERFORMED BY LOUISIANA LOCAL PRACTITIONERS
FOR THE YEARS 1965, 1968, and 1971
ACCORDING TO THE SIZE OF
PROFESSIONAL STAFF

Types of Services Performed	Per Cent of Services Performed By a Professional Staff of								
	1-5			6-10			over 10		
	1965	1968	1971	1965	1968	1971	1965	1968	1971
Auditing	28	32	36	29	33	38	30	36	34
Estate Planning	2	2	4	5	6	7	4	5	5
General tax work	30	32	32	25	23	22	30	27	26
Management services	5	6	7	5	6	9	4	6	9
Write-up Work	31	26	19	35	29	22	25	19	16
Other	4	2	2	1	3	2	7	7	10

work, and general tax work, while including the function of rendering professional advisory services which enable the client to make more efficient, effective, and economical use of its resources in order to better achieve the firm's overall objectives. Furthermore, the American Institute of Certified Public Accountants has stated that management services are related to areas such as:

- The management functions of analysis, planning, organizing, and controlling
- The introduction of new ideas, concepts, and methods to management
- The improvement of policies, procedures, systems, methods, and organizational relationships
- The application and use of managerial accounting, control systems, data processing, and mathematical techniques and methods, and
- The conduct of special studies, preparation of recommendations, development of plans and programs, and provision of advice and technical assistance in their implementation.¹

The average local practitioner is prone to have a much narrower definition of management services. In many instances, the local CPA would indicate in the questionnaire that he does not perform any or at least only an insignificant portion of his practice in the management services area. However, the local practitioner generally tends to consider management services work of the nature defined by the American Institute of Certified Public Accountants to be included in the area of auditing or in a miscellaneous category. The inference seems to be that the typical local

¹Statement on Management Advisory Services No. 1
(New York: American Institute of Certified Public Accountants, Inc., 1969), p. 3.

practitioner would define management services to include the function of applying modern quantitative techniques to better enable a firm to operate in an optimum manner and/or perform other types of work which traditionally bares no direct relationship to accounting, such as market research. On the other hand, a few practitioners, especially local firms, appear to agree with the definition of the American Institute of Certified Public Accountants of management services since several firms which indicated frequent services in the management services area also indicated that a significant percentage of their services consisted of management services. Approximately thirty-three per cent of the local practitioners indicated that over ten per cent of their services are performed in the area of management services. Nevertheless, approximately forty-five per cent of the sole practitioners and twenty-two per cent of the local firms indicated that they do not perform any management services work. However, the listing of selected management services areas in the questionnaire indicated that these local practitioners do occasionally perform management services work, although it is generally not performed in all the different areas listed in the questionnaire. Most of the services listed in the other category appeared to be management services based on the fact that many practitioners mentioned the type of services they did include in this miscellaneous category. Generally these services would be classified as

management services by the American Institute of Certified Public Accountants.

Write-up work consists of a major part of the services offered by some practitioners.--The area of write-up work was examined in detail since it was recognized early in the study that a significant minority of local practitioners are heavily engaged in this type of work.

A definite trend away from write-up work among local practitioners may be found. The decline in write-up work is in all likelihood due to the fact that most of the local practitioners included in the survey indicated that this type of work is less profitable than auditing, taxation, or management services. A more detailed analysis of the percentage of fees derived from various services is presented in Appendix B. Lower fees from write-up work are probably caused by the fact that this type of work required fewer skills than other types of services performed by local practitioners. The lack of requirement of higher level skills has led to increased competition from noncertified accountants, commercial data processing centers, banks, public bookkeepers, and others who have contributed to lower fees.

The local practitioners who have just recently entered the accounting field are more prone to rely to a greater degree on write-up work than the better established local practitioners. New local practitioners tend to accept write-up work with the apparent motive of using it as a

stepping stone to more profitable services. Furthermore, new local firms tend to up-grade their services at a faster pace than the new sole practitioners.

When used in moderation, write-up work could serve a useful social service since many small firms are in need of such help. New employees could also use write-up work as a training tool. Write-up work should be prepared under the supervision of a CPA by lesser skilled employees with the aid of data processing equipment. However, the local practitioner who is prone to rely too heavily on write-up work which is especially performed mainly by himself on manual equipment will tend to work longer hours in order to earn an acceptable income. This type of local practitioner will also tend to be too busy to build a competent staff and also fail to obtain the modern skills required for more advanced services.

EDP equipment serves as an efficient means of performing write-up work.--The local practitioner who performs write-up work with the aid of data processing equipment generally is able to offer his clients better services than the practitioner who prepares data on manual equipment. Data processing equipment generally enables the local practitioner to perform write-up work more economically. Additionally, EDP equipment usually supplies a more thorough analysis of the data which provides the practitioner, for example, with automatic calculation of selected accounting tools such as

ratio analysis. Thus, the client obtains data which probably has been analyzed by the local practitioner with the aid of automatic equipment rather than just receiving ledgers and reports which contain little or no analysis.

A computer research study sponsored by the American Institute of Certified Public Accountants found that in general data processing centers "are prepared to design and produce any service that is feasible, economical, and marketable."¹ Furthermore, the optimum use of a data processing center requires an accountant who is acquainted with the available selection of package services. The local practitioner should also be able to suggest alternative reports when the conditions warrant. The data processing center enables the competent accountant to develop more sophisticated and more timely reports for his client than is economically feasible with manual equipment.

With the achievement of additional experience and the possession of a more sophisticated knowledge base, the local practitioner can begin to automate the decision making functions. Thus, the local CPA can begin to provide management with the foundation of a satisfactory management information system. The optimum use of a commercial data processing center will lead to more informative data for use in small business decision making functions. This process will

¹Relationships Among CPAs, Banks and Service Bureaus
--Computer Research Studies No. 4 (New York: American Institute of Certified Public Accountants, Inc., 1966), p. 12.

no doubt be an important step in solving the major problems of managing a small business.

The trend toward less reliance on write-up work will continue in the future.--The trend to less reliance on write-up work is expected to continue to accelerate in the immediate future. In 1965, for example, write-up work amounted to ten per cent or less of the total activities of approximately twenty-five per cent of the local practitioners included in the survey. The percentage of local practitioners performing ten per cent or less of their work in the area of write-up work increased to about thirty-three per cent in 1968 and more significant is the projected increase to approximately forty-six per cent in 1971. A slightly higher percentage of local firms are included in the ten per cent or less category.

On the other hand, write-up work still plays a dominant role in the services performed by a large segment of local practitioners. Approximately eighteen per cent of the local firms and twenty-two per cent of the sole practitioners performed forty per cent or more of their services in 1968 in the area of write-up work. Local firms generally project a major trend away from this type of work as only six per cent predict that write-up work will play a significant role in their activities by 1971. The large percentage of write-up work among local firms in 1968 tends to be concentrated among the newer firms. These new firms generally plan to expand their services into the more profit-

able areas in the next several years. However, the write-up activities of the sole practitioners, who are heavily engaged in this area, are projected to remain at the same level. About twenty-two per cent of the sole practitioners expect to perform over forty per cent of their services in the write-up area in 1971. This is the same percentage as in 1968.

Practitioners heavily engaged in write-up work generally tend to use manual equipment.--Of the practitioners heavily concentrated in write-up work in 1968 the majority of them are still using manual equipment rather than the more efficient and effective EDP equipment. About seventy-one per cent of sole practitioners and seventy per cent of the local firms which perform forty per cent or more of their services in the write-up area in 1968 use manual equipment. If the data for the sole practitioners included in the study are projected to represent the entire group of Louisiana sole practitioners, the projection indicated that over one fifth of the sole practitioners in the state of Louisiana are now performing and plan to continue performing in the next three years the major portion of their activities in the less profitable and less skilled area of a CPA practice.

A publication of the American Institute of Certified Public Accountants stated in 1962 that "In general, CPAs will be well advised to concentrate on giving advice and

counsel to clients and minimize clerical service except where no one else is available to perform satisfactorily."¹ With the aid of commercial data processing centers, generally someone is presently available to perform data processing services in an efficient manner for a small business with the help and advice of a local CPA. The local practitioners who plan to continue to be heavily concentrated in the write-up area could perform a much greater service to themselves and to their clients by expanding their services to include more advice and counsel.

Common Body of Knowledge

The present day CPA should possess a broad knowledge base.--The Committee on Education and Experience Requirements for CPAs of the American Institute of Certified Public Accountants has developed a model education program for the beginning accountant. The program serves only as a foundation program and the professional accountant is expected to expand his knowledge base after leaving the classroom. The model program does suggest that the knowledge requirements for a present day accountant are broader than his predecessor's. More emphasis is now placed on areas such as mathematics, quantitative applications in business, communications, computer science, higher level economics, and human

¹James H. MacNeill, ed., Accounting Practice Management Handbook (New York: American Institute of Certified Public Accountants, 1962), p. 737.

relations which generally were not as heavily emphasized in the past.¹ Although the model program is directed toward the beginning CPA, the program is a good guide as to the broad areas in which a CPA should be knowledgeable.

The knowledge of an average local CPA is stronger in some areas than others.--The data in Table 4 indicate that the knowledge level of the average local practitioner is not evenly balanced. On one end of the spectrum, the local CPA tends to be strong in the areas of taxation and is fairly well informed in certain peripheral areas of accounting such as management, finance, and human relations. The local CPA is somewhat less informed in the area of marketing. Nevertheless, the Committee on Education and Experience Requirements of CPAs stated that an "extensive knowledge of marketing is not required of the CPA."² Furthermore, the average local practitioner has at least a good working knowledge of the opinions of the accounting principles board and the professional code of ethics.

On the other end of the spectrum, the local CPA tends to lag behind in the areas which have had a rapid knowledge explosion and/or peripheral areas which were formerly not recognized as essential knowledge requirements of a professional accountant. The weak knowledge areas are

¹Academic Preparation for Professional Accounting Careers (New York: American Institute of Certified Public Accountants, Inc., 1968), pp. 7-12.

²Ibid., p. 9.

TABLE 4

ANALYSIS OF THE DEGREE OF KNOWLEDGE
POSSESSED BY THE PARTNER MOST
KNOWLEDGEABLE IN EACH
SELECTED AREA

Knowledge of	Degree Of Knowledge Expressed As A Percentage According To A Professional Staff Of											
	1-5				6-10				over 10			
	N	G	GW	EX	N	G	GW	EX	N	G	GW	EX
COMPUTER SCIENCE												
3. Computer language such as COBOL	<u>65</u>	<u>20</u>	<u>15</u>	<u>0</u>	<u>50</u>	<u>34</u>	<u>16</u>	<u>0</u>	<u>20</u>	<u>40</u>	<u>27</u>	<u>13</u>
4. Computer system hardware controls	<u>61</u>	<u>25</u>	<u>14</u>	<u>0</u>	<u>56</u>	<u>38</u>	<u>6</u>	<u>0</u>	<u>20</u>	<u>33</u>	<u>33</u>	<u>14</u>
5. Controls outside the computer	<u>46</u>	<u>34</u>	<u>18</u>	<u>2</u>	<u>39</u>	<u>44</u>	<u>17</u>	<u>0</u>	<u>14</u>	<u>40</u>	<u>33</u>	<u>13</u>
7. Elements of a computer system design	<u>46</u>	<u>39</u>	<u>15</u>	<u>0</u>	<u>39</u>	<u>50</u>	<u>11</u>	<u>0</u>	<u>27</u>	<u>33</u>	<u>20</u>	<u>20</u>
8. Flow charting	<u>28</u>	<u>46</u>	<u>24</u>	<u>2</u>	<u>28</u>	<u>50</u>	<u>22</u>	<u>0</u>	<u>20</u>	<u>33</u>	<u>27</u>	<u>20</u>
11. Main components of a computer system	<u>52</u>	<u>36</u>	<u>12</u>	<u>0</u>	<u>33</u>	<u>56</u>	<u>11</u>	<u>0</u>	<u>33</u>	<u>20</u>	<u>33</u>	<u>14</u>
23. Use of test decks in auditing a computer system	<u>65</u>	<u>23</u>	<u>12</u>	<u>0</u>	<u>61</u>	<u>39</u>	<u>0</u>	<u>0</u>	<u>20</u>	<u>47</u>	<u>33</u>	<u>0</u>
TAXATION												
20. Taxation of individuals .	<u>0</u>	<u>2</u>	<u>66</u>	<u>32</u>	<u>0</u>	<u>0</u>	<u>33</u>	<u>67</u>	<u>0</u>	<u>0</u>	<u>20</u>	<u>80</u>
21. Taxation of corporations .	<u>0</u>	<u>2</u>	<u>74</u>	<u>24</u>	<u>0</u>	<u>0</u>	<u>33</u>	<u>67</u>	<u>0</u>	<u>0</u>	<u>20</u>	<u>80</u>
22. Taxation of trusts	<u>7</u>	<u>20</u>	<u>64</u>	<u>9</u>	<u>6</u>	<u>22</u>	<u>44</u>	<u>28</u>	<u>7</u>	<u>7</u>	<u>33</u>	<u>53</u>

TABLE 4--Continued

Knowledge of	Degree Of Knowledge Expressed As A Percentage According To A Professional Staff Of											
	1-5				6-10				over 10			
	N	G	GW	EX	N	G	GW	EX	N	G	GW	EX
OTHER ACCOUNTING AREAS												
1. A.P.B. opinions	4	55	39	2	6	33	61	0	0	7	73	20
2. Capital budgeting	24	42	32	2	22	45	33	0	14	40	26	20
6. Direct costing	15	43	40	2	17	72	11	0	7	47	40	6
18. Professional code of ethics	0	24	67	9	0	28	66	6	0	0	67	33
19. Statistical sampling methods	22	36	42	0	22	61	17	0	14	40	46	0
PERIPHERAL AREAS												
9. Linear programming	78	20	2	0	83	17	0	0	33	40	20	7
10. Macroeconomic theory	78	15	7	0	88	12	0	0	59	34	0	7
12. Microeconomic theory	78	13	9	0	88	12	0	0	59	34	0	7
13. Organization theory	43	32	23	2	44	45	11	0	33	20	40	7
14. Principles of human relations	15	42	43	0	11	50	33	6	20	40	40	0
15. Principles of finance	2	36	57	5	0	50	44	6	0	33	53	14
16. Principles of management	7	39	54	0	0	50	44	6	0	33	53	14
17. Principles of marketing	13	55	32	0	11	67	22	0	0	73	20	7

Note: N, G, GW, and EX are abbreviations for None, General, Good Working, and Expert, respectively.

those which are generally utilized in the management services area along with the effect of EDP on auditing. The data suggest that the larger CPA firms with professional staffs numbering over ten have the best overall knowledge level of the three categories of local practitioners. This higher level knowledge base of the larger local firms is especially noticeable in the areas of modern quantitative techniques and EDP.

A detailed examination of the data indicated that additional comment was needed in the areas of taxation, statistical sampling methods, operations research, management accounting techniques, and especially in the area of EDP.

Almost without fail the local practitioner is strong in the field of taxation.--The strongest overall field of knowledge of the local practitioner is in the general area of taxation. The local CPA's knowledge of individual and corporation taxation is especially strong, while their knowledge of estate taxation is somewhat weaker. The projected increase in demand in estate taxation will in all likelihood encourage the local CPA to obtain a greater degree of proficiency in this area.

The competition in the field of taxation appears to be becoming stronger. A franchised tax office is becoming a familiar sight in numerous American cities. Presently some franchised tax offices are even using computer facilities to prepare their clients tax return. Additionally, young

70
lawyers who have specialized in taxes are offering stronger competition. One authority in the field of taxation expressed the opinion that most young lawyers are much better trained in the field of taxation than many of their predecessors.¹

The evidence suggests more emphasis in the future tax practice will be placed on the planning phase. Furthermore, local practitioners must continue their practice of continuous study in the field of taxation in order to maintain their present knowledge level. The attraction of new members who are broadly trained in the field of taxation must continue in order for the CPA firms to retain their strong position in the tax field.

Statistical sampling is a potential problem area.--

One extremely weak point in the knowledge of a local practitioner is the tendency to have little or no knowledge of statistical sampling methods. A recent court case rendered the opinion that one particular sample performed during an audit was inferior.² The case does not offer any guidelines in the application of statistical sampling methods since it did not explain how it evaluated the sampling methods used by the auditor. However, the significant point is that in

¹William H. Westphal, "The Future of the CPA in Tax Practice," The Journal of Accountancy, CXXVII (June, 1969), 4.

²Escott, et al. v. Bar Chris Construction Corporation et al., United States District Court, Southern District of New York, 62 Civ. 3539, p. 111.

the future the courts will call upon the practitioner to justify his sampling method. It would seem from the evidence at hand that the majority of the local practitioners do not have the skills required to employ an acceptable statistical sampling method. During this present age of increasing numbers of court cases against CPAs, the typical local practitioner could be in a very weak position when trying to justify his sampling method.

The knowledge of operations research techniques tends to be nonexistent.--The majority of the practitioners have no knowledge whatsoever of operations research techniques. Operations research techniques offer exciting possibilities for use in the management services area especially when aided by EDP facilities. In general, operations research techniques enable a practitioner to solve familiar problems in an optimum and timely manner.

The suggestion has been expressed that "Ideally, one partner or senior staff man in any CPA firm should know how to apply these techniques (operations research) to the solution of specific client problems."¹ The ideal situation will probably not be attained in the near future. However, it would appear that the local CPA should be in a position to be able to recognize the types of problems which can be best

¹John L. Carey, The CPA Plans for the Future (New York: American Institute of Certified Public Accountants, 1965), p. 242.

solved by modern quantitative techniques. The local practitioner who possesses a general knowledge of operations research techniques could refer the client to someone who is proficient in this area. The lack of knowledge of modern quantitative techniques is probably due to the fact that most of the practitioners were not exposed to these techniques when they attended college.

A few local CPAs probably contribute to the inadequacy of some accounting systems.--The knowledge in the area of management accounting has expanded at a rapid rate in the last decade. The preface to the third edition of a recently published management accounting book expresses the opinion that "In all probability the past ten years cannot be matched for the rapidity of change in business management techniques."¹ The knowledge explosion has resulted in the supplying of a greater volume of pertinent data to management for internal decision making purposes. The explosion has further resulted in management making decisions on a more informed basis and demanding more services from their accountants than was generally provided in the past.

From the evidence gleaned from the local practitioner questionnaire, the failure of some small firms to install a satisfactory accounting system is not entirely due to

¹J. Brooks Heckert and James D. Wilson, Business Budgeting and Control (3rd ed.; New York: The Ronald Press Company, 1967), p. iii.

failure of the manager and his bookkeeper to possess adequate accounting skills. The data indicate that a significant number of local practitioners have no knowledge of the management accounting techniques of direct costing and capital budgeting. Further noted is the fact that the percentage of practitioners who have at least a good working knowledge of direct costing ranges from a low of eleven per cent among practitioners with a professional staff of from six to ten to approximately forty-four per cent for the other two professional staff categories. Moreover, direct costing techniques form the basis for designing financial statements to present information in a more optimum fashion for decision making purposes. In all likelihood, the fact that many local practitioners do not possess a good working knowledge of direct costing has led to the situation where some local CPAs are not prone to recognize the many advantages which result from designing financial statements for internal use. Thus, many small businesses in the future will probably continue to focus their financial statements only on the perceived needs of outsiders.

Over-investment in fixed assets will probably continue to be a major problem area for some small businesses due to the fact that many local practitioners do not possess at least a good working knowledge of capital budgeting. The local practitioners with a professional staff numbering ten or less are especially weak in this area since about one out of four has no knowledge whatsoever of capital budgeting.

The evidence suggests that in all likelihood the failure of many small enterprises to install an adequate accounting system is due to the lack of a good working knowledge of basic management accounting techniques on the part of the management of local firms and the firm's local practitioner. Clients of the less progressive local practitioners may be tempted to obtain the services of the more progressive practitioners. Of course, outside competitors, such as computer service centers, could be tempted to fill the void left by the less progressive CPAs.

The local practitioners knowledge of the computer tends to be inferior.--Perhaps no invention of modern times will have as great a long run impact on the local practitioner as the computer. The number of installed electronic data processing systems has grown at an accelerating rate from about 500 in 1956 to more than 5,000 in 1960. The estimation has been made that presently well over 60,000 such systems are to be found and that by 1975 there will probably be 250,000 installed computer systems.¹ Added to the total of installed computer systems is the many service bureaus which provide traditional services plus offering time sharing which will probably be a dynamic growth area in the future.

¹Noel Zakin, "The AICPA Responds to the Challenge of EDP," The Journal of Accountancy, CXXVII (March, 1969), 68.

The special committee of the Canadian Institute of Chartered Accountants assessed in 1967 the impact of electronic data processing on the accounting profession in the August, 1967, special issue of the Canadian Chartered Accountant. The committee recommended knowledge requirements for a member of the accounting profession who had a client who uses a computer. Selected knowledge requirements for a practitioner who has a client with a small card computer included an expert knowledge of the elements of systems design and controls outside the computer, a good working knowledge of the main components of a computer system and the use of test decks, and a general knowledge of computer systems hardware controls and concepts of programming languages.¹ The items included in the general knowledge and good working knowledge categories increase progressively in the required knowledge level according to the complexity of the EDP system.

Several studies sponsored by the American Institute of Certified Public Accountants examined the problem of the basic computer knowledge requirements of a CPA. The study of the common body of knowledge of beginning CPAs recommended a basic EDP knowledge level for beginners. The study recommends a basic knowledge of at least one computer system, ability to chart or diagram an information system of modest

¹Gordon H. Cowperthwaite, et al. "Practicing Accountants and the Computer--Section 2," Canadian Chartered Accountant, special issue (August, 1967), 31.

complexity, and have a working knowledge of at least one computer language.¹

The special auditing EDP task force recommended basic knowledge levels for the auditor of an EDP system. The study concluded that "the audit of a computer-based system requires the auditor to possess a good basic understanding of computers and computer data processing methods."² The study further concluded that the auditor should have a specific understanding of computer facility organization, documentation, controls, safeguards, and computer system audit techniques.

The evidence indicates that the average local practitioner is in a woeful position as far as being prepared for the computer explosion. The local practitioners with professional staffs ranging from one to ten are generally in an extremely poorly prepared position to take advantage of the computer explosion since from about forty to sixty per cent of the practitioners have no knowledge whatsoever of computer system hardware controls, controls outside the computer, elements of system design, and the use of test decks. The larger local firm is somewhat better prepared for the computer explosion, but its qualifications are usually significantly below the knowledge criteria recommended by the

¹Roy and MacNeill, Horizons for a Profession, p. 213.

²Gordon B. Davis, Auditing and EDP (New York: American Institute of Certified Public Accountants, Inc., 1968), p. 7.

special committees of the Canadian and American professional accounting societies.

The computer explosion has affected the local practitioner.--It was and still is convenient for many local practitioners to state that the relevance of the computer to a small CPA practice is neither immediate nor direct. However, the future has arrived and it is both immediate and very direct! No longer is it rare for a local practitioner to have a client who uses the facilities of a computer. As is shown in Table 5, only a very rare local firm does not have at least a few clients which use the facilities of a computer in processing and analyzing their data. Moreover, a sole practitioner is just as likely as not to have at least a few clients who use the computer.

One immediate and direct impact of the computer explosion is in the process of rendering an opinion on the financial statements of a client who uses the computer. Both of the special EDP committees of the Canadian Institute of Chartered Accountants and of the American Institute of Certified Public Accountants would seriously question the competence of the average local practitioner to audit clients who use the computer. The committee of the Canadian Institute of Chartered Accountants stated that in their opinion "it is the professional responsibility of the practicing accountant to ensure that the necessary knowledge of computer auditing techniques has been used before signing an

TABLE 5

ANALYSIS OF THE DEGREE OF FREQUENCY WHICH THE CLIENTS
OF LOCAL PRACTITIONERS USE COMPUTER FACILITIES
IN PROCESSING AND ANALYZING THEIR DATA

<u>Type of Practitioner</u>	Degree of Client's Use of Com- puter Facilities Expressed as a Percentage			
	<u>None</u>	<u>Few</u>	<u>Most</u>	<u>All</u>
All local firms	11	87	2	0
All sole practitioners	50	50	0	0
Professional staff 1-5	44	56	0	0
Professional staff 6-10	11	89	0	0
Professional staff over 10	7	86	7	0

audit opinion for any client who uses a computer."¹ The EDP Committee of the American Institute of Certified Public Accountants stated that, "If an audit involves a computer, the CPA must have sufficient competence in the methods and techniques of auditing EDP systems to enable him to conduct the audit properly."² Unfortunately, few of the local practitioners can sufficiently meet the criteria established by the two committees.

The evidence implies that the average local practitioner is employing traditional auditing methods in the rendering of an opinion on financial statements of clients who use the computer. However, the traditional approach ignores the effect which the computer has on the accounting system.

¹Cowperthwaite, et al. "Practising Accountants and the Computer-Section 2," p. 30.

²Davis, Auditing and EDP, p. 8.

For example, the computer makes a significant impact on the system of internal control. The CPA who audits a computer system must be concerned about programmed controls, hardware controls, controls over programming procedures, input controls, output controls, and organization controls. A major difference exists in traditional controls and controls associated with a computer system which forces a competent auditor to have a basic knowledge of the computer. The special committee of the Canadian Institute of Chartered Accountants concluded that, "in nearly every case the effect is significant enough that even with unlimited hard copy, the auditor must still review the computer system itself."¹

The computer has also changed the auditor's methods in other auditing areas due to such considerations as: the computer is a very fast and efficient auditing tool, sometimes there are gaps in the audit trail, and possibly the accounting system involves an outside service center. The combination of changes mentioned above which were brought about by the computer also led the staff committee of the American Institute of Certified Public Accountants to the conclusion that "The auditor may not properly ignore the

¹Cowperthwaite, et al. "Practising Accountants and the Computer-Section 2," p. 26.

computer in the audit."¹ Unfortunately, the data suggest that most local practitioners do ignore the computer.

The auditor's weakness in the EDP area has not gone unnoticed.--The deficiency in computer auditing methods has made a strong impression on many data processing specialists. In a recent article, one specialist stated that, "It's a simple matter for a crook with technical know-how and a little imagination to program a computer to fleece a company and fool its auditors."² Moreover, Robert Fanno, a leading computer theoretician at Massachusetts Institute of Technology stated that, "If I were a crook, I'd work through computers."³

Another authority in the EDP field visited the computer centers of various companies in order to determine what safeguards the firms had taken to protect their valuable data from manipulation, theft, and fire. The study found that very few companies had taken the necessary precautions. As far as manipulation is concerned the study found that "Those with the greatest capability in programming and EDP operations are the programmers, analysts, and operators, and not EDP management and auditors, who ought to be the

¹Davis, Auditing and EDP, p. 8.

²Alan Adelson, "Whir, Blink--Jackpot'. Crooked Operators Use Computers to Embezzle Money from Companies," The Wall Street Journal, April 5, 1968, p. 1.

³Ibid.

agents of control and security."¹ The study further found that most of the systems had been designed for easy access and egress rather than for adequate control. Files containing valuable and confidential information were usually accessible to anyone who cared to examine or tamper with the data. Additionally, master tapes and their back-up tapes were usually stored in the same place. This inadequate storage procedure would prevent reconstruction in case of fire or theft in the event all of the tapes were stolen or destroyed.

The failure of CPAs to understand fully the controls which are required by an EDP system is pointed out in the observations of the above study. The investigator found that "Program and data files are easily accessible to programmers, machine operators, and other personnel."² Thus, the EDP systems are not usually designed to prevent manipulation since internal control procedures are almost nonexistent.

The general lack of preparedness for the computer explosion has been recognized by the clients of CPA firms. The survey of the effect of EDP on the accounting profession sponsored by the Canadian Institute of Chartered Accountants disclosed that thirty-four per cent of Canada's largest companies "stated that they were not satisfied with the degree

¹Brandt Allen, "Danger Ahead! Safeguard Your Computer," Harvard Business Review, XLVI (Nov.-Dec., 1968), 100.

²Ibid.

of computer 'know-how' displayed by their auditors."¹ These firms are most likely to employ the largest accounting firms in Canada. The large accounting firms probably have a tendency to be better informed in the computer area than do local practitioners. There would seem to be a greater percentage of dissatisfied clients among the smaller businesses than among the giant corporations.

The evidence strongly supports the idea that the local practitioner must become as knowledgeable in the area of computers as he is now in the field of taxation. Furthermore, the accounting profession is shirking its professional responsibility as long as a basic knowledge of the computer is not the common "bag of tools" of most practitioners.

Some bright spots exist in the computer area especially in the large local firms with a professional staff numbering over ten. Several of the firms are well prepared for the computer explosion since they have in-house computer facilities and separate management services staffs which specialize in the computer services area.

The progressive practitioner tends to be rewarded in the long run.--The average local practitioner tends to be fairly strong in the traditional knowledge areas of accounting, but the knowledge explosion has left many practitioners

¹Cowperthwaite, et al. "Practising Accountants and the Computer-Section 2," p. 30.

deficient in such critical areas as management accounting techniques and EDP. The progressive local practitioner who keeps up to date through continuing educational programs will certainly be prone to perform a higher quality of services and command a higher level of fees than his less progressive counterpart. The progressive local practitioner will also tend to fare better in the courtroom than the local CPA who is not competent in certain vital areas as statistical sampling methods and EDP auditing procedures.

General Types of Management Services

Small practitioners are offering various types of management services to their clients.--One of the conclusions of the previous chapter was that most small businesses need part time expert counseling services. As is shown in Table 6, most local practitioners are offering management services in varying degrees to their clients.

Table 7 indicates that a significant number of practitioners also plan to increase the frequency of performance of management services in the future. Additionally, the data indicate that the request for services by clients roughly parallels the providing of such service. The finding confirms the conclusions of the previous chapter that the typical small firm generally does not recognize the areas in which they are deficient. Detailed statistics referring to clients requests for management services are presented in Appendix B.

TABLE 6

ANALYSIS OF THE EXTENT TO WHICH MANAGEMENT
SERVICES ARE PRESENTLY PERFORMED BY
LOUISIANA LOCAL PRACTITIONERS

<u>Type of Service</u>	Per Cent Of Management Services Performed By A Professional Staff Of								
	<u>1-5</u>			<u>6-10</u>			<u>over 10</u>		
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>
MANAGERIAL STUDIES									
1. Analysis of adding or dropping a product or department	<u>43</u>	<u>57</u>	<u>0</u>	<u>31</u>	<u>64</u>	<u>5</u>	<u>22</u>	<u>71</u>	<u>7</u>
2. Assistance in direct costing techniques	<u>47</u>	<u>53</u>	<u>0</u>	<u>41</u>	<u>59</u>	<u>0</u>	<u>29</u>	<u>64</u>	<u>7</u>
3. Assistance in incremental costing techniques	<u>62</u>	<u>36</u>	<u>2</u>	<u>84</u>	<u>16</u>	<u>0</u>	<u>50</u>	<u>43</u>	<u>7</u>
4. Assistance in advising whether or not one should start a business	<u>12</u>	<u>69</u>	<u>19</u>	<u>5</u>	<u>59</u>	<u>36</u>	<u>0</u>	<u>50</u>	<u>50</u>
5. Budgets	<u>19</u>	<u>65</u>	<u>16</u>	<u>5</u>	<u>79</u>	<u>16</u>	<u>7</u>	<u>79</u>	<u>14</u>
6. Buy or make analysis	<u>48</u>	<u>42</u>	<u>10</u>	<u>69</u>	<u>31</u>	<u>0</u>	<u>43</u>	<u>50</u>	<u>7</u>
7. Cost allocation	<u>28</u>	<u>58</u>	<u>14</u>	<u>21</u>	<u>74</u>	<u>5</u>	<u>0</u>	<u>86</u>	<u>14</u>
8. Economic order quantity analysis	<u>71</u>	<u>29</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>	<u>86</u>	<u>14</u>	<u>0</u>
9. Financing arrangements	<u>7</u>	<u>51</u>	<u>42</u>	<u>0</u>	<u>41</u>	<u>59</u>	<u>0</u>	<u>50</u>	<u>50</u>
10. Insurance analysis	<u>12</u>	<u>74</u>	<u>14</u>	<u>5</u>	<u>64</u>	<u>31</u>	<u>7</u>	<u>57</u>	<u>36</u>
11. Inventory control analysis	<u>31</u>	<u>55</u>	<u>14</u>	<u>16</u>	<u>84</u>	<u>0</u>	<u>0</u>	<u>64</u>	<u>36</u>
12. Management audit-evaluation of management	<u>50</u>	<u>43</u>	<u>7</u>	<u>53</u>	<u>47</u>	<u>0</u>	<u>64</u>	<u>31</u>	<u>5</u>
13. Mergers and/or reorganization	<u>46</u>	<u>49</u>	<u>5</u>	<u>21</u>	<u>74</u>	<u>5</u>	<u>0</u>	<u>71</u>	<u>29</u>
14. Replacement analysis and/or purchase of new facilities	<u>31</u>	<u>64</u>	<u>5</u>	<u>31</u>	<u>59</u>	<u>10</u>	<u>14</u>	<u>64</u>	<u>22</u>

TABLE 6--Continued

<u>Type of Service</u>	Per Cent of Management Services Performed By A Professional Staff Of								
	<u>1-5</u>			<u>6-10</u>			<u>over 10</u>		
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>
15. Review of organization structure	<u>36</u>	<u>59</u>	<u>5</u>	<u>21</u>	<u>69</u>	<u>10</u>	<u>0</u>	<u>86</u>	<u>14</u>
16. Analysis of non-recurring problems not mentioned above .	<u>16</u>	<u>76</u>	<u>8</u>	<u>16</u>	<u>63</u>	<u>21</u>	<u>7</u>	<u>71</u>	<u>22</u>
SYSTEMS									
1. Review feasibility of use of a punched card system	<u>41</u>	<u>57</u>	<u>2</u>	<u>31</u>	<u>69</u>	<u>0</u>	<u>7</u>	<u>86</u>	<u>7</u>
2. Reviewing computer proposals .	<u>39</u>	<u>59</u>	<u>2</u>	<u>31</u>	<u>69</u>	<u>0</u>	<u>7</u>	<u>79</u>	<u>14</u>
3. Performing computer feasibility studies	<u>59</u>	<u>36</u>	<u>5</u>	<u>36</u>	<u>64</u>	<u>0</u>	<u>29</u>	<u>57</u>	<u>14</u>
4. Supervising computer installation projects	<u>93</u>	<u>7</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>	<u>14</u>	<u>79</u>	<u>7</u>
5. Systems analysis	<u>34</u>	<u>47</u>	<u>19</u>	<u>31</u>	<u>48</u>	<u>21</u>	<u>7</u>	<u>71</u>	<u>22</u>
MARKETING									
1. Market analysis	<u>83</u>	<u>17</u>	<u>0</u>	<u>95</u>	<u>5</u>	<u>0</u>	<u>86</u>	<u>14</u>	<u>0</u>
2. Sales management: prices, channels of distribution . . .	<u>69</u>	<u>29</u>	<u>2</u>	<u>74</u>	<u>26</u>	<u>0</u>	<u>71</u>	<u>29</u>	<u>0</u>
3. Sales forecasting	<u>58</u>	<u>42</u>	<u>0</u>	<u>69</u>	<u>31</u>	<u>0</u>	<u>50</u>	<u>43</u>	<u>7</u>
PERSONNEL									
1. Evaluation of personnel	<u>26</u>	<u>67</u>	<u>7</u>	<u>41</u>	<u>49</u>	<u>10</u>	<u>7</u>	<u>79</u>	<u>14</u>
2. Selection of personnel	<u>29</u>	<u>62</u>	<u>9</u>	<u>16</u>	<u>74</u>	<u>10</u>	<u>7</u>	<u>71</u>	<u>22</u>
3. Training of personnel	<u>31</u>	<u>62</u>	<u>7</u>	<u>31</u>	<u>64</u>	<u>5</u>	<u>29</u>	<u>57</u>	<u>14</u>
4. Analysis of wage compensation plan	<u>31</u>	<u>67</u>	<u>2</u>	<u>31</u>	<u>48</u>	<u>21</u>	<u>22</u>	<u>56</u>	<u>22</u>

TABLE 6--Continued

<u>Type of Service</u>	Per Cent of Management Services Performed By A Professional Staff Of								
	<u>1-5</u>			<u>6-10</u>			<u>over 10</u>		
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>
MATHEMATICAL TECHNIQUES									
1. Break-even analysis	<u>31</u>	<u>57</u>	<u>12</u>	<u>10</u>	<u>85</u>	<u>5</u>	<u>7</u>	<u>86</u>	<u>7</u>
2. Capital budgeting	<u>41</u>	<u>52</u>	<u>7</u>	<u>26</u>	<u>74</u>	<u>0</u>	<u>22</u>	<u>56</u>	<u>22</u>
3. Linear programming	<u>98</u>	<u>2</u>	<u>0</u>	<u>95</u>	<u>5</u>	<u>0</u>	<u>71</u>	<u>22</u>	<u>7</u>
4. Multiple regression	<u>98</u>	<u>2</u>	<u>0</u>	<u>100</u>	<u>0</u>	<u>0</u>	<u>86</u>	<u>7</u>	<u>7</u>
5. Simulation	<u>98</u>	<u>2</u>	<u>0</u>	<u>100</u>	<u>0</u>	<u>0</u>	<u>86</u>	<u>7</u>	<u>7</u>
6. Operations research techniques not mentioned above	<u>86</u>	<u>14</u>	<u>0</u>	<u>74</u>	<u>26</u>	<u>0</u>	<u>64</u>	<u>29</u>	<u>7</u>

Note: N, OC, and FR are abbreviations for None, Occasionally, and Frequently, respectively.

TABLE 7

ANALYSIS OF THE LOUISIANA LOCAL PRACTITIONERS'
PROJECTION OF DEMANDS FOR
MANAGEMENT SERVICES IN 1972

Type of Service	Per Cent of Management Services Projected for 1972 By A Professional Staff Of								
	1-5			6-10			over 10		
	S	M	L	S	M	L	S	M	L
MANAGERIAL STUDIES									
1. Analysis of adding or dropping a product or department	<u>88</u>	<u>12</u>	<u>0</u>	<u>76</u>	<u>18</u>	<u>6</u>	<u>73</u>	<u>27</u>	<u>0</u>
2. Assistance in direct costing techniques	<u>88</u>	<u>12</u>	<u>0</u>	<u>70</u>	<u>24</u>	<u>6</u>	<u>64</u>	<u>36</u>	<u>0</u>
3. Assistance in incremental costing techniques	<u>92</u>	<u>8</u>	<u>0</u>	<u>94</u>	<u>6</u>	<u>0</u>	<u>55</u>	<u>45</u>	<u>0</u>
4. Assistance in advising whether or not one should start a business	<u>65</u>	<u>35</u>	<u>0</u>	<u>59</u>	<u>41</u>	<u>0</u>	<u>27</u>	<u>73</u>	<u>0</u>
5. Budgets	<u>70</u>	<u>30</u>	<u>0</u>	<u>18</u>	<u>82</u>	<u>0</u>	<u>45</u>	<u>55</u>	<u>0</u>
6. Buy or make analysis	<u>75</u>	<u>25</u>	<u>0</u>	<u>86</u>	<u>24</u>	<u>0</u>	<u>82</u>	<u>18</u>	<u>0</u>
7. Cost allocation	<u>77</u>	<u>23</u>	<u>0</u>	<u>59</u>	<u>41</u>	<u>0</u>	<u>55</u>	<u>45</u>	<u>0</u>
8. Economic order quantity analysis	<u>90</u>	<u>10</u>	<u>0</u>	<u>82</u>	<u>18</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>
9. Financing arrangements	<u>93</u>	<u>7</u>	<u>0</u>	<u>12</u>	<u>88</u>	<u>0</u>	<u>55</u>	<u>45</u>	<u>0</u>
10. Insurance analysis	<u>44</u>	<u>53</u>	<u>3</u>	<u>47</u>	<u>53</u>	<u>0</u>	<u>45</u>	<u>55</u>	<u>0</u>
11. Inventory control analysis	<u>65</u>	<u>35</u>	<u>0</u>	<u>47</u>	<u>53</u>	<u>0</u>	<u>55</u>	<u>45</u>	<u>0</u>
12. Management audit-evaluation of management	<u>77</u>	<u>23</u>	<u>0</u>	<u>47</u>	<u>53</u>	<u>0</u>	<u>45</u>	<u>55</u>	<u>0</u>
13. Mergers and/or reorganization	<u>73</u>	<u>27</u>	<u>0</u>	<u>35</u>	<u>65</u>	<u>0</u>	<u>18</u>	<u>82</u>	<u>0</u>
14. Replacement analysis and/or purchase of new facilities	<u>77</u>	<u>23</u>	<u>0</u>	<u>35</u>	<u>65</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>

TABLE 7--Continued

Type of Service	Per Cent of Management Services Projected for 1972 By A Professional Staff Of								
	1-5			6-10			over 10		
	<u>S</u>	<u>M</u>	<u>L</u>	<u>S</u>	<u>M</u>	<u>L</u>	<u>S</u>	<u>M</u>	<u>L</u>
15. Review of organization structure	<u>80</u>	<u>17</u>	<u>3</u>	<u>59</u>	<u>35</u>	<u>6</u>	<u>55</u>	<u>45</u>	<u>0</u>
16. Analysis of non-recurring problems not mentioned above .	<u>64</u>	<u>33</u>	<u>3</u>	<u>53</u>	<u>47</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>
SYSTEMS									
1. Review feasibility of use of a punched card system	<u>57</u>	<u>43</u>	<u>0</u>	<u>35</u>	<u>59</u>	<u>6</u>	<u>27</u>	<u>73</u>	<u>0</u>
2. Reviewing computer proposals .	<u>60</u>	<u>40</u>	<u>0</u>	<u>47</u>	<u>53</u>	<u>0</u>	<u>27</u>	<u>73</u>	<u>0</u>
3. Performing computer feasibility studies	<u>65</u>	<u>35</u>	<u>0</u>	<u>53</u>	<u>47</u>	<u>0</u>	<u>27</u>	<u>73</u>	<u>0</u>
4. Supervising computer installation projects	<u>72</u>	<u>25</u>	<u>3</u>	<u>59</u>	<u>41</u>	<u>0</u>	<u>36</u>	<u>64</u>	<u>0</u>
5. Systems analysis	<u>63</u>	<u>37</u>	<u>0</u>	<u>53</u>	<u>47</u>	<u>0</u>	<u>27</u>	<u>73</u>	<u>0</u>
MARKETING									
1. Market analysis	<u>88</u>	<u>12</u>	<u>0</u>	<u>71</u>	<u>29</u>	<u>0</u>	<u>73</u>	<u>27</u>	<u>0</u>
2. Sales management: prices, channels of distribution	<u>86</u>	<u>14</u>	<u>0</u>	<u>65</u>	<u>35</u>	<u>0</u>	<u>73</u>	<u>27</u>	<u>0</u>
3. Sales forecasting	<u>83</u>	<u>17</u>	<u>0</u>	<u>59</u>	<u>41</u>	<u>0</u>	<u>55</u>	<u>45</u>	<u>0</u>
PERSONNEL									
1. Evaluation of personnel	<u>81</u>	<u>16</u>	<u>3</u>	<u>59</u>	<u>41</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>
2. Selection of personnel	<u>81</u>	<u>16</u>	<u>3</u>	<u>47</u>	<u>53</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>
3. Training of personnel	<u>78</u>	<u>19</u>	<u>3</u>	<u>53</u>	<u>47</u>	<u>0</u>	<u>64</u>	<u>36</u>	<u>0</u>
4. Analysis of wage compensation plan	<u>81</u>	<u>16</u>	<u>3</u>	<u>53</u>	<u>47</u>	<u>0</u>	<u>55</u>	<u>45</u>	<u>0</u>

TABLE 7--Continued

<u>Type of Service</u>	Per Cent of Management Services Projected for 1972 By A Professional Staff Of								
	1-5			6-10			over 10		
	<u>S</u>	<u>M</u>	<u>L</u>	<u>S</u>	<u>M</u>	<u>L</u>	<u>S</u>	<u>M</u>	<u>L</u>
MATHEMATICAL TECHNIQUES									
1. Break-even analysis	74	26	0	47	53	0	55	45	0
2. Capital budgeting	55	45	0	47	53	0	55	45	0
3. Linear programming	87	10	3	88	12	0	73	27	0
4. Multiple regression	97	0	3	88	12	0	82	18	0
5. Simulation	97	0	3	88	12	0	82	18	0
6. Operations research techniques not mentioned above	94	6	0	83	17	0	73	27	0

Note: S, M, and L are abbreviations for Same, More, and Less, respectively.

A rapid growth in the performing of management services by local CPAs in the last several years has been noted. In 1962, the American Institute of Certified Public Accountants conducted a survey of the types of management services offered by smaller CPA firms.¹ The survey found that more than a third of the small CPA firms rendered services in the areas of insurance and data processing. Presently, more than ninety per cent of the practitioners included in the local practitioner sample perform insurance analysis and more than sixty per cent of the practitioners perform some type of service in the data processing area. Some local practitioners also offer extensive services in the management services area. Furthermore, the overwhelming majority of local practitioners stated that they believe that the majority of their clients have a need for some type of management services work. This belief has probably helped to lead to the increase in the performance of management services by small CPAs. A more detailed presentation of this data is given in Appendix B.

The more traditional services of assisting in financial arrangements, cost allocation, budgets, and inventory control analysis tend to be performed more frequently than are the more recently developed managerial accounting techniques. However, numerous local practitioners are occasionally performing many of the managerial studies which

¹Carey, The CPA Plans for the Future, p. 234.

most small businesses need so very much. An additional bright spot, as far as small businesses are concerned, is the fact that most CPAs are offering assistance to small businesses in the form of advising whether or not one should start a business.

Neither marketing studies nor especially assistance in modern mathematical techniques are widely offered by local practitioners. The general lack of knowledge of these areas by local practitioners is probably a major reason why services are offered very rarely. On the other hand, personnel studies tend to be offered extensively regardless of the size of professional staff.

The larger local firms are prone to offer management studies more frequently than are the smaller practitioners. There are still, however, a significant number of practitioners who perform either very few or none of their services in the field of management services. The rendering of management services by the majority of smaller local practitioners does not tend to be on a systematic, organized basis.

Separate management advisory services departments and staffs are becoming more common.---Some major developments are being made in the management services area besides the more frequent offering of such services. One development is the growth of separate management services departments in the larger CPA firms. At present the separate management services departments are almost entirely

100

confined to the largest local firms in the state of Louisiana. Nevertheless, as is shown in Table 8, a significant number of the smaller practitioners plan to establish a separate management services department at least by 1972. No doubt many of these smaller clients plan to grow in size in order to adequately staff this department. Also interesting to note is the fact that seventy per cent of all the local firms which now have a separate management services department did not have one three years ago. The evidence indicates that management services is a very swiftly growing area and that changes in the field are rapid and significant.

Another development which closely parallels the recent growth of separate management services departments is the use of full time management services personnel. Naturally the full time management consultants are almost entirely limited to the largest local firms. The duties of the personnel range from "performing all management services engagements" to areas of "budgets, control, reporting, and costing" to "computer systems." The number of full time management services personnel should continue to increase at a swift pace in the future along with the projected rapid growth of separate management services departments. Moreover, the growth of separate management services departments and the use of full time management consultants no doubt is due to the recognition that specialization is required

TABLE 8

ANALYSIS OF THE OCCURRENCE OF A SEPARATE MANAGEMENT
SERVICES DEPARTMENT AND PERSONNEL AMONG
LOUISIANA LOCAL PRACTITIONERS

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do you have a separate management services department?	2	98	5	95	33	67
A. If yes, did you have one three years ago?	0	100	0	100	33	67
B. If no, do you plan to have one three years from now?	24	76	30	70	37	45
2. Do you have any full time management services personnel?	2	98	0	100	26	74

Note: The answers to question 1B for the professional staff over ten category do not equal to one hundred per cent due to the fact that twenty-two per cent of the local firms indicated they were undecided whether or not they would establish a separate management services department in the next three years.

in order to offer a comprehensive variety of services in this rapidly changing and complex area.

Most local practitioners are beginning to establish EDP practices of varying complexity.--A review of the data indicated that the performance of data processing services should be examined in detail due to the lack of knowledge in this area. The local practitioner can begin to acquire an EDP knowledge by becoming involved in two complimentary programs. One of these programs involves the establishment of an EDP practice by performing services of varying degrees of complexity for clients in the area of installation of EDP equipment. The other program involves using EDP equipment to perform various services for clients. Both of these programs require the local CPA to obtain concurrently EDP knowledge through a continuing education plan.

The evidence indicates that the local practitioners are beginning to establish an EDP practice. Different complexity levels may be found in an EDP practice. One author has divided an EDP practice into three levels consisting of (1) reviewing computer proposals, (2) performing computer feasibility studies, and (3) supervising computer installation projects.¹ Logically, a local practitioner would begin his practice at the lowest level of reviewing computer proposals. This stage requires the CPA to review computer pro-

¹Victor E. Millar, "The Three Levels of EDP Practice," The Journal of Accountancy, CXXIII.(February, 1967), 42.

posals prepared by others. This level of EDP practice gives the practitioner valuable training and enables him to be in a better position to appraise the effect of the computer on the accounting system. Noted is the fact that a majority of practitioners with professional staffs numbering five or less are generally at this first level of an EDP practice. Conversely, about forty per cent of the small practitioners appear to be ignoring the effect of EDP on their practice.

The second and third levels of an EDP practice require a much more thorough knowledge of the EDP field than does the first level. The second level requires the CPA actually to perform the computer feasibility study. This level does enable the local practitioner to obtain experience in the EDP field and it also helps him to gain an EDP reputation. Noted is the fact that most of the practitioners with professional staffs ranging from six to ten have generally advanced to this second level.

The third level of an EDP practice requires the local practitioner to have an overall expert knowledge of the computer. The EDP committee of the Canadian Institute of Chartered Accountants stated that in addition to the knowledge requirements of an auditor, the public accountant who advises management in the EDP field should also possess the following requirements:

- expert knowledge of terminology and systems flow charting
- good working knowledge of elements of feasibility studies, alternative documentation and control techniques available in practice

--general knowledge of tape and random access components, management science techniques, organization of a data centre and package programmes. For more specialized consulting service, advanced training would be necessary; the requirements for this have not been analyzed in this report.¹

As is indicated by the requirements established by the Canadian EDP Committee, the third level of an EDP practice requires a complete commitment to the EDP field on the part of one or more members of the staff. Thus, the successful EDP practice at the third level requires one or more staff members to specialize in the EDP field.

The supervision of computer installation projects requires a basic understanding of systems design. The entire complex effect of the computer on the accounting system must also be taken into account during the installation. Furthermore, the installation of a computer will generally extend over a lengthy time period of up to two years. Due to lengthy installations, a fairly large EDP staff is required for a firm which provides frequent services in this area.

Due to the requirement of almost complete commitment to developments in the EDP field, it would be expected that the third level of an EDP practice would be generally confined to the larger local firms. The surprising finding of this study is the extensiveness of the third level practice by the larger firms. The overwhelming majority of the

¹Cowperthwaite, et al. "Practising Accountants and the Computer-Section 2," p. 32.

local firms with a professional staff numbering over ten included in the local practitioner sample are performing services at the third level of an EDP practice. Additionally, the majority of these large local firms expect to perform a larger percentage of their services in this area in the future.

Local practitioners are beginning to use EDP equipment.--The other phase of obtaining EDP training is through the use of computer equipment. However, the acquiring of an expert EDP knowledge cannot be achieved overnight. This educational process is an arduous task and it requires much time and effort to achieve an expert status in the EDP field. A computer research study sponsored by the American Institute of Certified Public Accountants recommends that the beginning phase of a CPA's EDP training be the use of a commercial data processing center.¹ The local practitioner could first begin to use the facilities of a data processing center by processing data either for one select client or a select group of clients or processing the data of his own firm. The EDP practice can be expanded beyond write-up work to include the automation of the decision making and control functions along with the management information system.

¹An Approach to the Use of EDP in an Accounting Practice-Computer Research Studies No. 6 (New York: American Institute of Certified Public Accountants, Inc., 1968), p. 10.

The successful use of a data processing center is dependent on sufficient planning and the possession of an adequate knowledge level by the local practitioner. By the process of using a progressive commercial data processing center the progressive practitioner can design the output for each client according to their information requirements. Much of the data produced by such a system is generally not available to the management of a typical small firm before the use of EDP equipment.

A treasurer of a small firm which had been persuaded by their local practitioner to convert their accounting system from a manual system to a data processing system stated that the EDP system had led to various benefits to the firm as the result of the supplying of timely and relevant information.¹ The firm now receives, at a reduction in cost, information such as performance reports, pre-prepared accounts receivable statements, breakdown of sales by department and item, completed listing of accounts receivable by age, and other relevant data. This relevant information has resulted in improved performance margins since decisions are not being made with the aid of pertinent data. Table 9 indicates that a direct relationship may be found between the use of computer facilities and the size of the practitioner's professional staff.

¹Norman E. Schley, "Electronic Data Processing Is for Everyone," The Journal of Accountancy, CXXI (April, 1966), 79.

TABLE 9

ANALYSIS OF THE USE OF COMPUTER AIDS
BY LOUISIANA LOCAL PRACTITIONERS

<u>Type of Computer Aid</u>	Percentage of Use According To A Professional Staff Of		
	<u>1-5</u>	<u>6-10</u>	<u>over 10</u>
In house computer facilities	0	5	27
Time-sharing computers with remote terminals	0	0	0
Computer service center for processing data	42	52	53
Computer prepared tax return	15	24	46
Make no use whatsoever of computer aids	57	32	27

Note: The percentages do add up to more than one hundred per cent due to the fact that some practitioners use more than one computer aid.

Local practitioners are not presently utilizing a time-sharing system.--The practitioner can progress from the traditional use of a commercial data processing center to the use of a time-sharing system. In this system, the CPA has direct access to the computer and its inventory of packaged programs by using remote terminals. Thus, this is a real-time system. The practitioner can also develop his own programs for use in such a system.

By using a time-sharing system, the progressive CPA can use the computer as an aid in preparing tax returns, planning in the estate tax area, performing sophisticated management services techniques, and performing various other activities in a timely manner. For example one CPA firm performed a sophisticated capital budgeting problem in nine-tenths of a second in computer time.¹ In effect, a time-sharing system enables a CPA to obtain almost the same advantages as the owning of his own computer.

The CPA who uses a time-sharing system gains valuable experience which can be used in advising businesses whether or not to use such a system. The experience could be a very valuable attribute if computer utilities come into wide use in the future. The real-time system experience will also be helpful to the firm which audits a firm which uses such a system.

¹Felix Kaufman, "Computer Time Sharing for the CPA," Management Services, V (November-December, 1968), 27.

A more sophisticated service associated with a real-time system is the process of designing, installing, and possibly operating such a system for a client. This type of service would be included in the third level of an EDP practice. The service would require someone who is an expert in the area. One authority in the time-sharing area stated that the necessary experience required to design and install such a system could rarely be developed within the CPA firm.¹ Further recommended was the idea that the staff required for higher level real-time service be recruited from the computer industry. Additionally, noted is the idea that none of the CPA firms included in the sample use the facilities of a time-sharing system.

Ownership of own computer is fairly extensive among large local firms.--The practitioner could progress one step further by owning his own computer. The ownership of a computer would have to be restricted to a firm with sufficient staff to enable personnel to specialize in this area since this step requires expert computer knowledge. The ownership of computer facilities does serve as a valuable training aid in the auditing of computer systems and the use of a computer in the performing of sophisticated management services techniques. Ownership also enables the firm to provide whatever services they deem feasible for their clients.

¹Vern E. Hakola, "Computer Time-Sharing and the CPA--Opportunity or Problem?," The Journal of Accountancy, CXXVII (January, 1969), 68.

The ownership of computer facilities is almost completely limited to the larger CPA firms included in this study. However, the ownership of a computer is not rare among the larger firms as approximately one fourth of the firms with professional staffs numbering over ten possess one.

This study has found that a few local practitioners are knowledgeable in the EDP area. Moreover, many local practitioners are beginning to achieve some knowledge in the computer science area. On the other hand, a significant number of local practitioners have not made an attempt to obtain any knowledge in this field.

Evaluation of Data

The smaller practitioner is fast approaching a crossroad.--The data suggest that the average local practitioner is at a crossroad. The knowledge explosion has resulted in the situation where certain services can only be satisfactorily performed by specialists. An individual practitioner cannot be expected to be able to devote his full attention to the continuous developments in the EDP field and also be an expert in the fields of taxation and modern quantitative techniques. The very small practitioner, especially the sole practitioner, will in all likelihood be forced to offer only a limited specialized service to its clients. Only the larger local firms will come close to offering the comprehensive service which is now offered

in some fashion by almost all of the local practitioners.

The evidence further indicates that the local CPA of the future must become proficient in the EDP field in order to audit many of his present day clients. The transition of small businesses from manual equipment to automatic equipment will in all likelihood accelerate at an even faster pace in the future. Furthermore, EDP systems will become more complex and gaps in the audit trail will force auditors to consider the computer in their audit. It is not too late for the local CPA to obtain a satisfactory EDP knowledge, but the learning process will be long and arduous.

The auditor should have at least a general knowledge of management service techniques.--The local practitioner must determine to what extent he shall offer management services. At the minimum, an auditor should act as a generalist which would require a general knowledge of modern management services techniques in order that the auditor can recognize areas which can be improved by employing more efficient methods. The auditor acting as a generalist could refer his client to a CPA who is proficient in the problem area.

A medium sized local firm could most advantageously offer management services in those areas in which their clients need the greatest help, provided the areas are not so specialized that providing such services are not economically feasible. Less frequently required services and very

specialized services could be obtained for their clients by referral to other CPAs who are competent in the area.

The larger local CPA firms will in all likelihood continue the trend toward separate management services departments staffed by specialists. Most of these larger firms will probably own their computer or use a time-sharing system in order to offer optimum EDP services. Additionally, most of these larger firms will be in a position to offer a wide range of management services in a systematic manner.

An in-depth study of EDP auditing procedures is needed.--The rapid computer explosion has had a direct impact upon most local practitioners. The situation does express an urgent need for an in-depth study by the American Institute of Certified Public Accountants pertaining to the minimum procedures according to complexity levels which must be employed in the auditing of a client who uses the computer. The inclusion of the results of this proposed study into an additional auditing standard would serve a two fold purpose. The proposed standard would first alert CPAs as to minimum acceptable EDP auditing procedures. This standard could possibly prevent the suing of an unknowing but incompetent EDP auditor with financial disaster a possible result. Secondly, the proposed standard would help to assure the business community that they receive an adequate audit. Furthermore, the proposed standard will help to preserve the reputation of the accounting profession.

Further developments are needed in the statistical sampling area.--The superior weight of the evidence suggests that sampling methods such as examining each invoice which falls on the heavy brown line could probably not be justified in a court case. The American Institute of Certified Public Accountants has taken some steps to help overcome the deficiency in the statistical sampling area. For example, a significant portion of the in the staff training program--level one (1) is devoted to statistical sampling. Self study booklets are now available in this area. However, despite these measures a large segment of the local practitioner sample still does not have a good working knowledge of statistical sampling methods.

However, the major point is that sufficient evidence cannot be gathered with the use of a sampling method based on hunch or intuition. One who uses an acceptable statistical sampling method can state that the evidence is correct as presented subject to a certain degree of probability within stated degrees of variation. The CPA who uses an unscientific sampling method cannot state that the evidence gathered is sufficient since he has no proven method of deciding how many and what items should be examined. Therefore, when used in the appropriate circumstances, a properly drawn statistical sample can gather evidence which can stand up under the scrutiny of competent impartial experts.

In order to further alert the accounting profession to the potential problem area of gathering insufficient

evidence the suggestion that the standards of field work be altered to include a provision that an acceptable statistical sampling method be used when applicable. For example, the third standard of field work could be changed to state that sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmation with the aid of acceptable statistical sampling methods when applicable to afford a reasonable basis for an opinion regarding the financial statements under examination.

The data also raises questions in such areas as independence and management services, system of referrals, and types and extent of continuing educational programs. These topics will be covered in detail in the succeeding chapters.

Summary and Conclusion

A brief review of the chapter.--The data implies that some noticeable trends in both the areas of common body of knowledge and the general types of services offered by local practitioners are found. The average practitioner tends to have an excellent knowledge of taxation and a good knowledge of the traditional peripheral areas of accounting. The local CPA is prone to lag behind in areas which have been involved in a knowledge explosion. Additionally, the average practitioner does not have as broad a knowledge as has recently been recommended by the common body of knowledge study sponsored by the American Institute of Certified Public Accountants.

The typical local practitioner is rapidly phasing out write-up work. The percentage of services performed in the areas of auditing and management services is increasing while general tax work is on a fairly level plateau. The average local practitioner performs a variety of management advisory services work but generally not on a systematic, organized basis. The more traditional management services engagements are being performed more frequently while EDP and the more modern managerial accounting techniques are being performed occasionally. Moreover, marketing studies and modern quantitative techniques are rarely performed.

The larger firms with professional staffs numbering over ten generally are more progressive than the small practitioners. However, some practitioners regardless of their size have been almost completely oblivious to the developments in the accounting field.

Conclusions drawn from data presented in the chapter.--The evidence indicates that most local practitioners are beginning to provide a larger percentage of their services in the areas where most small businesses are deficient. Unfortunately, still remaining is a hard core of local practitioners including about twenty per cent of the sole practitioners who persist in performing the majority of their services in the less skilled area of write-up work. Additionally, the hard core group of practitioners are generally

performing the write-up work with inefficient manual equipment.

Several areas of knowledge are found where the local practitioner tends to be weak. Furthermore, this weakness influences the type and quality of services which the local practitioner performs. The local CPA's major weak-knowledge areas include EDP, modern managerial accounting techniques, and statistical sampling methods.

The evidence implies that local practitioners have not taken full advantage of the immense capabilities of the computer. The failure to take full advantage of the computer explosion is mainly due to the fact that the average practitioner has a poor knowledge of computer science. The EDP knowledge level of most practitioners is significantly below the minimum standards recommended by a special EDP committee sponsored by the Canadian Institute of Chartered Accountants for the purpose of either auditing a client who uses a computer or for rendering management services in the EDP area. It is recommended that in view of the accelerating growth in the acquisition of computers by firms of various sizes that the American Institute of Certified Public Accountants establish minimum auditing procedures pertaining to the rendering of an opinion of the financial statements of a client who uses the computer.

Many local practitioners are preparing themselves to meet the challenge of the EDP era. These practitioners in all likelihood will find that the computer is a most power-

ful ally. The less progressive local CPAs may well be looking forward to early retirement.

Modern managerial accounting techniques is another weak-knowledge area. The weakness is not as wide spread as in the EDP field, but it does effect the types and quality of services some local practitioners render to their small clients. These less progressive practitioners are prone to overlook the value of an accounting system designed to supply relevant data for internal use. However, small business studies mentioned in the previous chapter indicated the major weaknesses of small businesses is the failure to gather and use pertinent data for decision making functions. On the other hand, many practitioners are occasionally performing some services in the managerial accounting area.

An opinion rendered in a recent landmark court case declared that a sample taken by an auditor was not representative of the entire universe. This case illustrates the importance of gathering evidence when applicable by an appropriate statistical sampling method. The evidence indicates that a significant segment of the sample of Louisiana local practitioners do not possess a good working knowledge of statistical sampling methods. It is suggested that the field standards be amended to state that when appropriate that evidence be gathered with the aid of an appropriate statistical sampling method. The proposed change would stress the importance of gathering evidence which would be exonerated upon close examination by competent authorities.

Conditions change and knowledge increases at swift rates, the local practitioner should be cognizant of such events and take appropriate action. Doubtlessly, the larger local firms will continue to develop separate management advisory services departments and staffs along with the use of a time-sharing system or the possession of their own computer in order to continue to offer a wide variety of services in a competent manner.

CHAPTER IV

AN EXAMINATION AND DISCUSSION OF THE PRESENT AND POSSIBLE FUTURE EXTENSION OF AUDITING SERVICES PROVIDED BY LOCAL PRACTITIONERS

General Types of Audit Services

Various forms of ratio analysis may be supplied along with a short-form report.--The purpose of this chapter is to analyze the services local practitioners provide in conjunction with the process of rendering an opinion on the fairness of representations in financial statements. Additionally, the chapter will explore the feasibility of extending the present attest function.

Available are various services which the local practitioner can supply his clients in addition to the short-form auditor's report. The computation of carefully selected ratios would be a simple, but powerful, tool which could be included in the overall package of services which the auditor performs for his client.

The extent of ratio analysis performed by local CPAs varies according to each CPA and type of client.--The data in Table 10 indicate ratios are frequently provided by the

TABLE 10

GENERAL TYPES OF SERVICES PERFORMED BY LOUISIANA
LOCAL PRACTITIONERS IN CONJUNCTION WITH THE
RENDERING OF AN OPINION ON
FINANCIAL STATEMENTS

Expression As A Percentage Of The
Degree Of Services Performed By A
Professional Staff Of

<u>Type of Service</u>	<u>1-5</u>				<u>6-10</u>				<u>over 10</u>			
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>AL</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>AL</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>AL</u>
1. Compute pertinent ratios	<u>12</u>	<u>28</u>	<u>46</u>	<u>14</u>	<u>6</u>	<u>38</u>	<u>28</u>	<u>28</u>	<u>0</u>	<u>29</u>	<u>71</u>	<u>0</u>
2. Compare present ratios with prior ratios	<u>12</u>	<u>27</u>	<u>44</u>	<u>17</u>	<u>6</u>	<u>33</u>	<u>33</u>	<u>28</u>	<u>0</u>	<u>29</u>	<u>64</u>	<u>7</u>
3. Compare clients ratios with industry ratios	<u>40</u>	<u>44</u>	<u>14</u>	<u>2</u>	<u>44</u>	<u>50</u>	<u>6</u>	<u>0</u>	<u>29</u>	<u>50</u>	<u>21</u>	<u>0</u>
4. Written explanation of possible reasons why ratios are outside of tolerance limits	<u>51</u>	<u>33</u>	<u>12</u>	<u>4</u>	<u>28</u>	<u>44</u>	<u>28</u>	<u>0</u>	<u>29</u>	<u>64</u>	<u>7</u>	<u>0</u>
5. Comparison of actual results with budgeted figures	<u>20</u>	<u>63</u>	<u>17</u>	<u>0</u>	<u>22</u>	<u>61</u>	<u>17</u>	<u>0</u>	<u>7</u>	<u>64</u>	<u>29</u>	<u>0</u>
6. Provide management letter de- scribing deficiencies in the in- formation for internal planning, control, and decision making . .	<u>20</u>	<u>50</u>	<u>18</u>	<u>12</u>	<u>11</u>	<u>50</u>	<u>28</u>	<u>11</u>	<u>7</u>	<u>25</u>	<u>57</u>	<u>11</u>

Note: N, OC, FR, and AL are abbreviations for Never, Occasionally, Frequently, and Always, respectively.

local CPA during the course of an audit. Doubtlessly the use of a computer service center by many local CPAs is partially responsible for the frequent calculation of ratios. Unfortunately, most small business managers are not adequately able to interpret the significant findings which are associated with ratio analysis. Auditors, however, usually do not provide a written comprehensive analysis of the significant information provided by the ratios. Thus, the evidence indicates that auditors usually calculate and compare ratios, but the more essential and costly service of a written comprehensive analysis of the data is only occasionally provided. On the other hand, approximately eight per cent of the local practitioners do not provide their clients any assistance whatsoever in the ratio analysis area.

The larger local CPA firms more frequently tend to provide the various services associated with ratio analysis except for written explanation of reasons of why the ratios are outside of the tolerance limit. The other two professional staff categories tend to exhibit fairly similar characteristics. The fact is noted that the local firms included in the professional staff category of one to five were usually more progressive than their sole practitioner counterparts.

A management letter provides a more comprehensive service to clients compared to ratio analysis.--A more comprehensive service which can be provided along with ratio

analysis in an audit would be a management letter. A well developed management letter would result in a very sophisticated report to management.

Ideally, a comprehensive management letter briefly and concisely describes in a written form the major problem areas in the internal information system for planning, controlling, and decision making. Furthermore, the local practitioner is in a position to assist the client in correcting the problem area or referring the client to someone who is competent in the deficient area. This type of report when prepared in a satisfactory manner makes a most positive contribution to the management of a small firm. Moreover, a management letter would also serve a useful purpose in a large corporation.

The data in Table 10 pertaining to the management letter are in all likelihood misleading. The management letter appears to be mainly oriented toward internal control based on such facts as the local practitioner's knowledge level and elaborations by certain local CPAs in the questionnaire that the management letter is generally limited to internal control.

Internal control has been defined as follows:

Internal control comprises the plan of organization and all of the coordinate methods and measurers adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational effi-

ciency, and encourage adherence to prescribed managerial policies.¹

The preceding is a very broad definition of internal control which could include such items as budgetary control and statistical analysis. Doubtlessly, the scope of most management letters is primarily concerned with the safeguard of assets, reliability and accuracy of accounting data, and compliance with company policies.

The advantages of a management letter are many.--The advantages of a management letter are manifold. One advantage is that the written form is a very effective medium to communicate suggestions. A survey sponsored by the American Institute of Certified Public Accountants studied the relationship between oral and written communication among small local CPAs and their clients. The study found that fifty-six per cent of the small clients did act on most of the written recommendations made by their CPAs, but only thirty-three per cent of these clients acted on most of the oral recommendations.²

The value of a written report is further demonstrated by the experience of a CPA who became the auditor of a

¹Internal Control (New York: American Institute of Certified Public Accountants, 1949), p. 6.

²Richard C. Rea, "Management Letters," The Journal of Accountancy, CXXIV (July, 1967), 75.

company which was dissatisfied with its former auditors.¹ The new auditor orally brought to the attention of management the fact that several serious factors could lead to possible disastrous results. The recommendations were not acted upon, but the company did suffer its first loss in its history which amounted to \$90,000. Again recommendations were requested from the accountant by management. This time recommendations were put in written form. The board of directors did accept the practitioner's plan of action and profit levels recovered dramatically the next year to approximately \$50,000. The local practitioner concluded that the recommendations would not have been fully accepted and the required cooperation might not have been as freely given if the advice had not been put in a written form. Problem areas are certainly less likely to be forgotten when they are put in a written form. The evidence does indicate that written reports are much more likely to receive attention than an oral presentation.

Management letters tend to improve the relationship between the CPA and his client.--Another value of the management letter is that it tends to strengthen the professional relationship between the client and his CPA. Many small managers are not well versed in accounting. The management letter, doubtlessly, is considered by many of the

¹Richard C. Rea, "The Management Letter," The Journal of Accountancy, CXXV (January, 1968), 75.

small business managers to be the only tangible evidence of the internal value of an audit. Many small businessmen apparently feel that the auditors short-form report only serves the purpose of satisfying creditors and external stockholders.

Many managers expect the CPA to advise their firm in the area of internal information systems. William A. Paton, a pioneering accounting theorist, stated that if he were a businessman he would expect his accountant to possess the following characteristics:

I would want to find someone of first-rate ability who would seek to become as fully acquainted with my affairs and operations as the terms of the engagement made possible, who would be very much concerned as to the success of my business and who would not lose sight of his responsibility to me and my interests. . . .¹

Doubtlessly, many small firms feel that the CPA is qualified to render management advice and should do so. Since the growth and prosperity of a business is highly dependent on the adequacy of the information system, any major deficiencies in this system noted by a CPA would in all likelihood lead to a more favorable client relationship.

A management letter provides an outside independent professional judgment of the firm.--A significant attribute of a management letter is that it presents an outside inde-

¹William A. Paton, "Accounting and Utilization of Resources," Journal of Accounting Research, I (Spring, 1963), 47.

pendent professional view of the vital information system. An independent competent outside opinion is especially valuable to a small firm which does not have an internal audit staff. Nevertheless, a fresh independent appraisal is also a valuable aid to any firm regardless of physical size.

The management letter also helps to prevent misunderstandings.--The minimization of misunderstandings is another advantage of a management letter. If a defalcation occurs due to a weakness in the internal control system or management discovers after abnormally low profits that a weak point in the information system is mainly responsible for the loss, the CPA would be in a better position to protect himself if a management letter did describe these weaknesses. Moreover, management letters can point out the status of deficiencies reported in prior letters. Thus, the management letter serves as a historical record with an objective of serving the needs of the client and protecting the local practitioner.

Additional management services are a likely result of a management letter.--Another principal advantage of a management letter is that it tends to result in additional services for the local CPA. The management letter helps to delineate between regular audit work and management services. The separation of the two types of work will permit the separation of the billing and usually result in higher fees.

The separation of management services from auditing work enables the local practitioner to appeal to the financial savings which are generated from management services work. This appeal to the profit motive serves to benefit the client by means of more efficient operation and helps to enhance the CPA in the eyes of management.

The cost of a management letter in some situations may be a negative aspect of this valuable service.--A possible disadvantage of a management letter is that it may be costly. The additional cost is dependent on such considerations as the degree of coverage of the management letter and the thoroughness of the auditing procedures. A management letter geared mainly to internal control as contrasted to the entire internal information system would be fairly nominal in cost, but less effective than a broader report. On the other hand, an effective management letter may well be worth its cost to all parties concerned. The management letter may lead to the correction of major shortcomings of a firm whose efficiencies will probably result in a greater growth rate. Efficient operations will probably lead to greater demands by the small business for management services. If the major shortcomings were not corrected, the firm might have failed and the CPA would have lost a valuable client.

Due to the regular audit requirements of reviewing the system of internal control, a management letter which is

generally restricted to internal control should not result in a major cost item. One small CPA firm expressed the opinion that "the time required in preparing the management letter is not a significant element in the auditor's time budget."¹ In all likelihood the cost of such a letter will be recovered many times over by both the client and the local practitioner.

A questionnaire serves as a foundation for the management letter.--The procedural examination necessary for a management letter can be performed very effectively with the aid of a questionnaire. The length of the questionnaire would be determined in part by the type and size of the client. Some of the management control questionnaires which are used in actual practice range from a short two-page, twenty-five-key-question form to a more extensive form consisting of seventeen pages with about one hundred questions including a few open-ended questions.² The questionnaires are designed to examine more closely those areas which have a high degree of probability of being deficient.

Table 11 indicates that a slight majority of the Louisiana local practitioner sample have developed an inter-

¹Egon Von Kaschnitz, "Management Letters for Clients of Small Accounting Firms," The Journal of Accountancy, CXXI (February, 1966), 38.

²Henry De Vois, ed., Management Services Handbook (New York: American Institute of Certified Public Accountants, Inc., 1964), p. 30.

TABLE 11

PERCENTAGE OF LOUISIANA LOCAL PRACTITIONERS
WHOSE AUDIT PROGRAM CONTAINS AN INTERNAL
INFORMATION SYSTEM QUESTIONNAIRE

<u>Question</u>	Percentage of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do your audit programs contain a check sheet for the purpose of examining the firm's information system for internal planning and control?	56	44	58	42	77	23

nal information system questionnaire. The data in Table 10 suggest that the internal information system questionnaire is not employed in all of the audits performed by such practitioners.

A management letter should not be too long since this would very likely have a tendency to discourage reading of it by top management. The letter should be brief and should not include insignificant items. Suggestions which are not practical should also not be included. In effect, the management letter should make effective and practical recommendations in a concise manner with emphasis on possible savings if feasible.

An ideal time to submit the management letter is after the interim examination.--Before the management letter is presented to top management a closeout conference should be held with personnel who will be involved in the findings. The conference will enable the CPA to confirm the findings with the concerned employees. The CPA should also try to convince these employees that the purpose of the management letter is to enable the firm to operate in a more efficient manner and is not being used as a punitive device.

The management letter is finally presented to management both orally and in written form. In some cases, other devices such as visual aids may be used to support the written findings. In larger companies, a second letter containing more details could be sent to middle management.

The management letter may be supplied to the client with the short-form report. However, a more advantageous time to present the management letter might be after the interim examination. One accounting firm found that the period after the interim examination was the ideal time to submit such a letter.¹

One advantage of submitting the management letter after the interim examination is that the client's staff generally has more available time to cooperate in such an investigation. Another advantage is that the audit steps performed in the interim examination generally lend themselves to such a letter.

As a general rule, the management letter is only occasionally provided by local practitioners to their audit clients.--The data indicate that generally Louisiana local practitioners are in the category of only occasionally supplying their clients with a management letter. An important indication of the data is that the auditing services provided by local practitioners vary greatly not only according to each individual practitioner or firm, but also according to the different characteristics of each audit client. Some practitioners frequently provide their audit clients with a comprehensive ratio analysis along with a

¹Mitchell O. Humphrey, "Management Letters--Image Builders for the CPA," The Journal of Accountancy, CXXIII (January, 1967), 31.

management letter while a few practitioners do not supply any of their clients any information except a short-form report. Between these two extremes lie the majority of local CPAs.

The evidence suggests that a few small businesses do receive essential information from their CPA pertaining to the major management deficiency area in an average small business of the internal information system. On the other hand, the majority of small firms are not completely receiving the type of internal information which they need to enable them to operate in a more efficient manner. Moreover, almost ten per cent of the local practitioners supply none of their clients with any written form whatsoever concerning the small firms internal information system.

General Areas of Possible Audit Extension

Additional auditing services are greatly needed.--

Evidence previously mentioned disclosed that many small businesses are not being operated in an efficient manner. A significant number of the established small firms and most of the beginning new small businesses will eventually end in failure. This significant failure rate plus the fact that about one out of seven small firms is presently operating at a loss and probably many more are operating at subsistence levels indicate an existence of significant inefficiencies involving a substantial social cost in most small businesses. This social cost comprises not only an inefficient use

of natural resources, but also affects the welfare of many millions of small business proprietors and their employees and families.

An important point which should be considered is whether or not the accounting profession can help solve this small business dilemma. Previously cited evidence strongly indicates that the major deficiency of small business is the failure to use accounting information in the functions of planning, controlling, and decision making. In effect, the average small firm needs someone to render competent outside advice. Since the local practitioner is closely associated with most small businesses, it would appear that the local CPA would be in an excellent position to offer the small firm independent, objective, and relevant advice and assistance.

A logical extension of the attest function would be to include some phase of the internal information system.--

The next item to be considered is the various services in connection with the audit which the local practitioner could render to the small firm. At this point the feasibility of such services will be deferred for later consideration. A logical area for the extension of auditing services would appear to be a review of some phase of the internal information system. The internal information system is the company's lifeline. The necessity of reviewing information needs is suggested in the following:

CPAs should ask managements what information they need to operate more effectively. In fact, the independent CPA might well discern information needs which managements fail to perceive because they are too intimately involved. Any survey of information needs should ignore cost and time factors at the outset, since modern processing methods might well make practical what once was not.¹

Recent developments in information technology are enabling many companies to establish sophisticated information systems. The computer explosion with its rapid speed and huge memory is resulting in significant improvements in the integrated information system. New computer based analytical techniques are providing management with information which has more depth and breadth than ever before experienced.

The effect of this improved information system is to enable management to make decisions based on fact rather than on intuition or hunch. This improved information has tended to result in improving the odds in favor of making the optimum decision.

Research indicates that a direct relationship exists between poor auditing practices and the less than optimum internal information system.--A year long survey was made by a large management consulting firm concerning the operating characteristics of thirty-three exceptionally well-managed companies which use a computer. The companies were of varying sizes ranging from sales of one-half million dollars to over two hundred million dollars. The survey found that

¹Marvin L. Stone, "From the President," The CPA, XLVIII (April, 1968), 2.

approximately twenty-five per cent of these firm's computer budgets are spent on systems and programs planning with proportionately more spent on systems planning by firms with the largest computer budgets.¹ Additionally, the study found that these companies are increasingly spending more of their time and money in improving their internal information systems.

An immensely important finding of the above cited study was that "There is a significant correlation between poor auditing practice and less-than-optimum computer systems performance."² These firms use either an internal auditing staff or other staff personnel to review their internal information system. This observation indicates that a frequently adequate periodic review of the internal information system tends to result in more effective information for decision making.

The data indicate that large corporations are beginning to develop sophisticated internal information system. Furthermore, small businesses are very deficient in the internal information system area. In fact, the local practitioner can perform his greatest service to business and society by reporting on the adequacy of some phase of the

¹James W. Taylor and Neal J. Dean, "Managing to Manage the Computer," Harvard Business Review, XLIV (September-October, 1966), 101.

²Ibid., p. 107.

internal information system if such an extension of the attest function is both proper and feasible.

Auditing services of varying complexity can be offered in the internal management area.--One possible service in the general internal management area would be an extension of the present management letter which is presently mainly concerned with internal control. The proposed report on the internal information system would be in addition to the opinion expressed on the representations of the mainly external financial statements. The proposed expanded management letter would be a mandatory requirement pertaining to the effectiveness of the information system for planning, controlling, and decision making.

Another possible service would be to go beyond the proposed report on the internal information system to require a management audit. This type of audit would certainly be much more extensive than the report on the internal information system.

The attest function is slowly evolving to meet the needs of society.--In order to determine the propriety of extending the attest function, a brief review of this function should be considered. The attest function has slowly evolved over time to reflect more nearly the needs of society. At first, the attest function was primarily concerned with a completed commercial venture. For example, the formulation of a partnership to sponsor a long sea voyage

created a need for a cash audit. These ventures were completed after stated objectives were achieved and interim audits were not necessary.

The attest function was expanded as businesses began to establish manufacturing and trading companies of a fairly continuous nature. The attest function was broadened to include a periodic audit producing financial reports. This type of audit was fairly crude as compared to present day audits and consisted primarily of counting procedures. These counting procedures did extend beyond cash to include other accounts such as inventories. As the businesses became larger and more continuous and creditors became more numerous, the financial reports evolved into the attestation of financial statements. The major audit function was to perform a review of the balance sheet items including emphasis on the detailed testing of such items. The income statement tended to serve only as a link between successive balance sheets.

The primary accounting objective gradually progressed to that of providing information to stockholders and other investors as opposed to presenting information mainly for management and creditors. The income statement became the more important statement and the balance sheet began to serve as a link between succeeding income statements. The emphasis in the attest function was on the determination of the fairness of the representations in the financial statements. Detailed testing was de-emphasized and auditing of

procedures became primary. The reliance on the system of internal control became the keystone of auditing.

The attest function further evolved as the need for additional information was again recognized. The funds statement became a major financial statement with the objective of presenting more meaningful information primarily to external parties.

The attest function still appears to be in a state of flux.--The attest function does not give the appearance of remaining static. Recently the Accounting Principles Board of the American Institute of Certified Public Accountants expressed the opinion that "general price-level financial statements or pertinent information extracted from them present useful information not available from basic historical-dollar financial statements."¹ Presently the Accounting Principles Board suggests that price-level information may be presented in addition to the basic historical-dollar financial statements, but not as the basic financial statements. Price-level financial statements will likely be required along with historical-dollar statements in the not too distant future.

The present attest function has been defined as resulting "in the expression of an opinion by an independent

¹Financial Statements Restated for General Price-Level Changes--Statement of the Accounting Principles Board--No. 3 (New York: American Institute of Certified Public Accountants, Inc., 1969), p. 12.

expert that a communication of economic data by one party to another is fairly presented."¹ Moreover, the primary meaning of the word attest is to bear witness. The attest function would appear to have within its scope the ability to render an opinion on the effectiveness of the internal information system provided other criteria are met. The fact is noted that this type of attestation would be a major departure from present day practice. However, the history of the attest function has been one of gradually changing to meet the needs of society.

Certain criteria must be satisfied before any attest function can be seriously considered.--In order to consider extending the attest function to any area, certain basic criteria must be satisfied. The following considerations must be examined and satisfactorily answered before any extension of the attest function can be seriously considered:

1. Does the proposed extension pertain to a major function of accounting?
2. Is there a great need for extending the attest function?
3. Does the local practitioner have a social obligation to extend the attest function to an area which has an overwhelming need provided such extension is practical?

¹Herman W. Bevis, "The CPA's Attest Function in Modern Society," The Journal of Accountancy, CXIII (February, 1962), 28.

4. Is there measurable verifiable data which can be evaluated with the use of practical auditing standards and procedures which are within the present state of the art in order to arrive at an independent, objective, and reliable audit opinion?
5. Do the local practitioners possess the required minimum knowledge level for the proposed audit extension?

A Review and Analysis of a Proposed Attest Extension

Accounting is essentially an information system.--

In order to determine whether or not the internal information system is a major function of accounting, the discipline of accounting must be defined and the framework of accounting must be identified. The definition of accounting has been broadened over a period of time reflecting the changing role of accounting. In 1941, the Accounting Terminology Committee of the American Institute of Certified Public Accountants devised the following definition of accounting:

Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.¹

¹Accounting Research and Terminology Bulletins
(final edition; New York: American Institute of Certified Public Accountants, 1961), p. 9.

With recent developments in the field of accounting such as modern managerial accounting techniques and complex information systems, the above definition was found to be too limited to describe the field of accounting. The definition of accounting was broadened in 1965 by Accounting Research Study No. 7 to include the following:

Accounting is the body of knowledge and functions concerned with systematic originating, authenticating, recording, classifying, processing, summarizing, analyzing, interpreting, and supplying of dependable and significant information covering transactions and events which are, in part at least, of a financial character, required for the management and operation of an entity and for the reports that have to be submitted thereon to meet fiduciary and other responsibilities.¹

The fact is noted that the definition of accounting cited above recognizes the important role of internal reporting to management and also emphasizes the responsibility of supplying information for both external and internal purposes.

In 1966, a Committee to Prepare a Statement of Basic Accounting Theory of the American Accounting Association defines accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information."² The

¹Paul Grady, Inventory of Generally Accepted Accounting Principles for Business Enterprises--Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, Inc., 1965), p. 4.

²A Statement of Basic Accounting Theory (Evanston: American Accounting Association, 1966), p. 1.

preceding definition is more encompassing than any of the other definitions cited above. The definition appears to reflect more accurately the sweeping changes which have occurred in the business community. This concise definition spotlights as one of the major functions of accounting the providing of information to internal users for use in planning, controlling, and decision making. Furthermore, this information can be based on non-transaction data along with transaction data.

A member of the American Accounting Association Committee which defined accounting stated that the committee found the basic motive of accounting was "essentially an information system--a process for developing and transmitting information."¹ This information provided by accounting is for both internal and external purposes. The American Institute of Certified Public Accountant's Planning Committee stated in 1966 that "The information which accounting provides is essential for (1) effective planning, control, and decision-making by management, and (2) discharging the accountability of organizations to investors, creditors,..."²

¹Norton M. Bedford, "The Nature of Future Accounting Theory," The Accounting Review, XLII (January, 1967), 82.

²"A Description of the Professional Practice of Certified Public Accountants," The Journal of Accountancy, CXXII (December, 1966), 61.

A primary function of accounting is to provide internal information.--The professional accounting societies agree that the primary function of accounting is to provide information for both internal and external purposes. The statement has been made that "For management accounting, the motive is service to management, and it serves by providing information. The accountant measures what occurs, processes the data and provides information for management planning, decision-making, and control."¹ A similar opinion was expressed by Accounting Research Study No. 3, when it stated that "Accounting supplies much of the comprehensive and dependable information that management needs to control and administer the resources in its charge efficiently and productively."²

The function of accounting and its needs are eloquently stated in the following:

Accounting is an information system which provides significant, meaningful financial information about the firm--both for internal management use and for external financial reporting. What it needs is more management analysis.³

¹Neil C. Churchill and Myron Uretsky, "Management Accounting Tomorrow," Management Accounting, L (June, 1969), 46.

²Robert T. Sprouse and Maurice Moonitz, A Tentative Set of Broad Accounting Principles for Business Enterprises --Accounting Research Study No. 3 (New York: American Institute of Certified Public Accountants, 1962), p. 1.

³Sidney Davidson, "The Day of Reckoning--Managerial Analysis and Accounting Theory," Journal of Accounting Research, I (Autumn, 1963), 117.

The evidence cited does indicate that one of the two major objectives of accounting is to provide information for internal use. Provided that other criteria are satisfied, the data support the extension of the attest function to some phase of the internal information system.

A review of the internal information system is needed greatly.--The overwhelming weight of the evidence indicates that an enormous need for an independent and objective opinion on the effectiveness of the internal information system exists. Various studies indicate a direct relationship may be found between profitability and an adequate accounting system. Other studies suggest that recommendations will be acted upon much more frequently when put into a written form.

An important consideration is whether or not an independent review of the internal information system would more likely lead to efficient operations. Present evidence indicates that a direct relationship between an audit of the information system and its effectiveness exists. Thus, the facts do suggest that an audit of the internal information system would be a giant step toward solving the major deficiency of small businesses. Furthermore, such a step would in all likelihood be an important aid to a huge corporation.

The auditor has a social obligation to extend his services when feasible if a major need exists.--The present

evidence indicates an extensive social need for an independent and competent review of a firm's internal information system may be found. One of the criterion of a profession is that it renders an essential service to society when practical. Dean Roscoe Pound defined a profession as "A group of men pursuing a learned art as a common calling in the spirit of public service--no less a public service because it may incidentally be a means of livelihood."¹ The emphasis of a profession on service is also pointed out by John L. Carey when he states that "This is the concept which largely distinguishes a profession from business--that professional men assume an obligation to place public service ahead of reward."²

The fact is recognized that a professional man must be able to earn a satisfactory net income. However, it must be noted that a profession gains recognition as such by providing society with a unique service. The services which a profession renders should grow to meet the ever changing major needs of society as improvements in knowledge and techniques permit such an extension. If a profession does not render to society services which are most needed and are also feasible, the profession ceases to perform its duty.

¹Roscoe Pound, The Lawyer from Antiquity to Modern Times (St. Paul: West Publishing Company, 1953), p. 5.

²John L. Carey, Professional Ethics of Certified Public Accountants (New York: American Institute of Certified Public Accountants, 1956), p. 50.

Furthermore, the profession loses standing in the eyes of the public and may well cease being a profession.

Since one of the primary functions of accounting is to provide internal information and a great need exists for an independent review of the internal information system, the accounting profession would appear to have a social obligation to extend the attest function to this area if it is practical. Thus, such an extension of the attest function should be made if an independent, objective, and reliable opinion can be rendered on verifiable data in accordance with practical standards. If the accounting profession does take advantage of the opportunity to provide the type of services which are demanded by society, the future of accounting is almost limitless. However, if accounting restricts itself to only a part of the total verifiable information, then no doubt others will eventually seize the opportunity to provide such valuable service.

An audit of the internal information system is not as comprehensive as a management audit.--In order to perform an independent, reliable, and objective audit, measurable data along with practical standards must be available for evaluation. The attestation of the internal information system is not as demanding as a management audit. The proposed internal information audit would render an opinion on the effectiveness of the internal information system to supply to management in an understandable form the data which

is required in order to operate in a satisfactory manner. The objective of this type of an audit is not to determine whether or not the firm made a correct decision based on an optimum amount of information, but the actual purpose of the proposed audit report is to state whether or not management receives and considers relevant verifiable information which is generally free from bias. For example, the auditor would determine whether or not sufficient information was presented and considered when management evaluated major investment proposals. The auditor would determine whether appropriate capital budgeting techniques were used and whether management considered various alternatives. The auditor's report would not state whether the optimum decision was reached. However, the report should state the possible consequences of not using appropriate techniques when applicable and should suggest ways in which the firm could improve their information system.

The review of the internal information system would be an extension of the review of the internal control system. This type of review stresses review of procedures rather than detail counting and checking of items. The standards required for such an audit would consist of those items which should be included in an adequate accounting system according to each particular industry and size of firm.

Standards for an internal information report are within the state of the art.--Since the standards suggested for an internal information report would pertain to the con-

tents of a present day adequate accounting system, the standards would be within the present state of the art. Of course, these standards would change with the development in knowledge and techniques.

General standards could be established by the American Institute of Certified Public Accountants. The individual practitioners could adapt the general standards to fit their particular circumstances. The auditor could use a questionnaire check sheet to perform a review of the internal information system. An example of one part of such a check sheet pertaining to budgets might consist of the following:

I. Budgets

- A. Does the firm employ a formal budgeting system?
- B. If the answer to A is yes, does it include:
 - 1. All relevant divisions and departments?
 - 2. All necessary operating budgets?
 - 3. All necessary financial budgets?
 - 4. Timely comparison of actual results to flexible budget?
 - 5. Written explanation of reasons for results outside of tolerance limits?
- C. Does management consider this information in the decision making process?

Since the proposed audit of the internal information system is basically the same type of review of procedures as

an internal control review and the proposed auditing standards are within the present state of the art, measurable data which can be compared with practical standards may be found. Thus, the suggestion is made that independent, prudent, professional auditors would arrive at the same opinion on the relevancy of the internal information system.

This type of audit would not be as informative as a management audit since it would not be as inclusive. The internal information report would not contain a forecast of future performance nor would it include an overall judgment of the performance of management.

A management audit would be a valuable aid to any firm regardless of size.--Like the audit of the internal information system, the management audit is mainly a review of procedures. Various concepts of a management audit have been proposed. Neil Churchill and Richard Cyert define management audit "as an audit which results in a statement of opinion by a CPA with regard to the performance of the management function."¹ Another definition has been advanced by William Campfield which describes a management audit as "an informed and constructive analysis, evaluation, and series

¹Neil C. Churchill and Richard M. Cyert, "An Experiment in Management Auditing," The Journal of Accountancy, CXXI (February, 1966), 39.

of recommendations regarding the broad spectrum of plans, processes, people, and problems of an economic entity."¹

The broadest concept of a management audit would include the rendering of an opinion on the effectiveness of all the various functions of management. To be included would be functions such as planning, organization, staffing, direction, and control. This all inclusive type of management audit would certainly be a valuable aid to any firm regardless of size, but it would tend to be costly.

All of the definitions of a management audit stress in some aspect an independent, objective, and comprehensive appraisal of the total situation of a company. One of the major purposes of such an audit is to inform management of the principal problem areas in order that corrective action can be taken to prevent significant injury to the business. Generally a management audit would include future projections.

Several government auditing agencies have been performing a type of management audit during the last several years. These audits tend to be of a negative type in that only certain selected areas are examined in detail. These audits are prone to be selective due to such factors as time, cost, and lack of satisfactory guidelines.

A comprehensive management audit is not presently feasible.--The major problem with such a revolutionary ex-

¹William L. Campfield, "Trends in Auditing Management Plans and Operations," The Journal of Accountancy, CXXIV (July, 1967), 42.

tension of the attest function is that there are no generally recognized and accepted management principles and procedures; and, moreover, auditing standards and procedures have not yet been fully developed in this area. Management is a relatively young discipline. Many facets of management are still being developed and many questions have yet to be solved. However, several management authorities have made great strides in developing possible forerunners of future generally accepted management principles and procedures. Furthermore, auditing standards and procedures would have to be developed to reflect any generally accepted management principles. Therefore, the evidence suggests that further developments must be made in the management audit area before such an extension of the attest function can be further critically analyzed and evaluated.

A budget audit would be a possible service which could be provided to the business community.--A comprehensive evaluation of management would be at the opposite end of a spectrum as compared with a report on the internal information system. John L. Carey has suggested an audit extension which would lie on the broad spectrum between the two extremes mentioned above. This possible extension would include "attestation to business planning (prospective accounting), perhaps beginning with budgets."¹ This type of

¹John L. Carey, "What Is the Professional Practice of Accounting?," The Accounting Review, XLIII (January, 1968), 6.

audit would be a significant departure from the present at-test function since it would be concerned with future events.

The major objective of a budget audit is whether or not the inferences made by management in the preparation of the budget are reasonable. Auditing standards and procedures must be established along with budgeting standards and procedures in order that an objective opinion can be expressed on the reasonableness of the inferences made by management. These principles, standards, and procedures do not exist in a complete form at the present time.

Level of difficulty of performance goals in an area where budgeting principles and standards need further development.--An example of an area in which budgeting standards need to be improved is in the area of the difficulty level of performance goals. Overwhelming evidence indicates that performance goals and suitable working environment tend to motivate employees to be more productive. Current literature in budgeting usually supports the establishment of performance goals at a "low level" of difficulty which can be achieved about ninety per cent of the time by an average worker "who tries." However, recent studies in the field of psychology indicate that the level of productivity is linearly related to the difficulty of the goal.

Studies such as those by Dey and Kaur,¹ Locke and Bryan,² Locke,³ and Siegal and Fouraker,⁴ found in general that a goal which is harder leads to higher productivity than a goal which is easier. In fact, one study found that individuals are more productive when faced with harder goals contrasted to easier goals even when the probability of reaching these goals is less than ten per cent.⁵ These studies all point out the fact that a strong degree of correlation may be found between high goals and productivity.

In general, individuals will be more productive when their goals are harder as contrasted to easier goals. However, harder goals do have their drawbacks. A study by Locke in 1966 found that the hardest goals lead to the lowest degree of satisfaction with and liking for the task.⁶

¹Mukul K. Dey and Gurminder Kaur, "Facilitation of Performance by Experimentally Induced Ego Motivation," The Journal of General Psychology, LXXIII, (October, 1965), 247.

²Edwin A. Locke and Judith F. Bryan, "Performance Goals as Determinants of Level of Performance and Boredom," Journal of Applied Psychology, LI, (April, 1967), 129.

³Edwin A. Locke, "The Relationship of Intentions to Level of Performance," Journal of Applied Psychology, L, (February, 1966), 66.

⁴S. Siegal and L. E. Fouraker, Bargaining and Group Decision Making: Experiments in Bilateral Monopoly, (New York: McGraw-Hill, 1960), pp. 61-69.

⁵Locke, "The Relationship of Intentions to Level of Performance," p. 60.

⁶Edwin A. Locke, "The Relationship of Task Success to Task Liking: A Replication," Psychological Reports, XVIII, (April, 1966), 552-554.

Although this study does not measure the long run effects of harder goals, the assumption may be reasonably made that dislike of the job will lead eventually to turnover or to apathy.

On the other hand, a study by Stedry and Kay found that performance on "easy" goals would be significantly greater than performance on impossible goals.¹ Therefore, goals can be set so high that they are perceived as impossible.

The budget audit does not appear to be feasible at the present time.--The cited studies indicate that more research is needed in the area of difficulty level of goals before definite conclusions can be drawn. Other areas similar to the difficulty level of goals also need further research. The evidence does suggest that more research is needed in the budget auditing area before any audit extension can be realistically considered. The opinion has been expressed that the crucial step to be performed in the budget audit field is the development of budgeting and budget-audit principles, standards, and procedures "so that firms and auditors have some framework to rely upon in developing budgets and in performing budget audits."²

¹Andrew C. Stedry and Emanuel Day, "The Effects of Goal Difficulty on Performance: A Field Experiment," Behavioral Science, II, (November, 1966), 469.

²Yuji Ijiri, "On Budgeting Principles and Budget--Auditing Standards," The Accounting Review, XLIII, (October, 1968), 667.

The internal management report appears to be the most realistic extension of the attest function.--At this time the most logical extension of the attest function appears to be a report on the internal information system. The auditing procedures and standards associated with the proposed audit are fairly similar to those of the review of the internal control system. Furthermore, most of the local practitioners at least occasionally prepare a management letter for their audit clients. Thus, the proposed audit procedures would be somewhat familiar to most CPAs.

Auditing procedures and standards associated with the proposed audit are within the present state of the art. Moreover, the proposed audit would be a most significant step in the direction of solving the major deficiency associated with a small business. The attest function could be further extended as developments are made in the management, budgeting, and auditing fields.

Knowledge levels do not appear to be an overwhelming obstacle to the proposed audit extension.--The local practitioners must possess a required minimum knowledge level in order to extend the attest function to the internal information system. The evidence gleaned from the Louisiana local practitioner questionnaire indicates that there is presently a significant minority of local CPAs which do not possess the minimum required knowledge levels for such an audit

extension (see Chapter III, pp. 73-90). The knowledge deficiency does not appear to be an overwhelming obstacle to such an extension.

One of the requirements of being a professional accountant is that one possess a common body of specialized knowledge. Furthermore, the assertion has been made that "growth in new knowledge must be accompanied by corresponding growth on the part of those in professional practice; they must demonstrate a capacity for self-development and self-renewal."¹ A minority of local practitioners should not impede the orderly growth of a profession.

Other problems are associated with the proposed audit extension, but they are not ones which should deter such an audit.--Other problems are associated with the proposed extension of the attest function. One problem is that such an extension would expose another area to legal responsibility. Due to the limited scope of the proposed internal information report, the legal implications of such an extension should be one with which the profession could live. Any profession can expect to be held accountable for unprofessional services.

Another problem associated with the proposed audit is that it would tend to be more costly. Of course, the additional time and cost associated with such an extension

¹Roy and MacNeill, Horizons for a Profession, p. 33.

will vary according to the services which are now performed by the local CPAs. The practitioners who presently prepare a management letter for their audit clients should not experience a significant increase in cost for an internal information report. Even the practitioners who never prepare a management letter should not encounter a prohibitive cost based on such factors as the scope of the audit and other practitioners experience with management letters. Management services generated by such an audit may well recover the costs associated with the proposed audit extension many times over.

Conclusions

The auditing services provided by local practitioners are not uniform.--The data imply that an unevenness associated with the auditing services provided by local practitioners may be found. Approximately ten per cent of the local practitioners do not provide any additional auditing services beyond the short-form report. On the other hand, most local CPAs compute ratios and compare them with prior figures. Furthermore, approximately forty per cent of the local practitioners frequently prepare management letters and about twenty per cent of the local CPAs frequently provide written explanations of why ratios are outside of tolerance limits. Very few practitioners compare ratios with budgeted figures which is probably due to the infrequent preparation of budgets by their clients. Thus,

the data suggest that an audit client of a local practitioner may receive audit service pertaining to internal operations ranging from no assistance whatsoever to a management letter which describes the major deficiencies in the internal information system.

The attest function should be extended in order to provide needed services.--The overwhelming weight of the evidence indicates that there is a huge social need for advice and assistance in the area of the internal operations of a firm. The data suggest that the local practitioner can render services of immense value to the small businessman by extending the attest function to rendering an opinion on the adequacy of the internal information system for planning, control, and decision making.

An extension of the attest function appears to be both feasible and practical. The required auditing standards and procedures are within the present state of the art. The proposed audit would result in an independent, objective, and reliable opinion based on the fact that verifiable data which can be judged by practical auditing standards and procedures may be found.

An internal information audit report would tend to enable the average small businessman to operate in a significantly more efficient, effective, and economical manner. Large corporations would also benefit from such an audit extension.

The accounting profession appears to have a social obligation to provide an internal information report based on such facts as: (1) there is an immense need for such a service, (2) this major deficiency area pertains to one of the major functions of accounting, and (3) such an audit extension is feasible. If accounting expects to remain a profession, it must render relevant services to society. That the accounting profession is fulfilling its professional obligations seems doubtful when it goes to considerable lengths to record data of a trivial nature, such as the recording of a paper clip transaction, and ignores notable events which cannot be expressed in monetary values.

CHAPTER V

AN INVESTIGATION AND DISCUSSION

OF THE REFERRAL SYSTEM

OF LOCAL PRACTITIONERS

Analysis of the Need for Referrals

Many reasons are apparent as to why a local CPA will make a referral.--The purpose of the chapter is to analyze and discuss the various aspects of the local practitioner's referral system. Any major weakness located in the referral system will be investigated in detail in order to examine and evaluate possible alternative measures which might make an improvement in the overall referral machinery.

Many reasons are apparent as to why a CPA does and/or should make referrals. One reason may be that the local practitioner is not conveniently located to perform the necessary services. Table 12 indicates that most of the Louisiana local firms included in the survey have clients which have an office in a state other than Louisiana. Such offices in other states, in all likelihood, create a travel obstacle in distant states when on location audits and management service work are desirable. The lack of certification in other states could also necessitate the use

TABLE 12

PERCENTAGE OF LOUISIANA LOCAL CPA FIRMS
WHICH HAVE CLIENTS WHO HAVE OFFICES
IN OTHER STATES AND/OR OPERATE
IN FOREIGN COUNTRIES

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do you have a client who has an office in a state other than Louisiana?	59	41	71	29	80	20
2. Do you have a client who is engaged in foreign opera- tions?	12	88	35	65	33	67

of a referee. Furthermore, the fact that approximately twenty-seven per cent of the local firms have clients engaged in foreign operations creates a situation which might require assistance from accounting firms which have offices in foreign countries. Such foreign activities of clients may lead to the use of CPA consultants in such specialized fields as taxation of foreign corporations.

The rapid increase in knowledge leads to more frequent referrals.--With the occurrence of the knowledge explosion and the broadening of the scope of accounting, it is highly questionable whether or not any Louisiana sole practitioner or local firm is competent in all the many phases of accounting services. In fact, the common body of knowledge data of the Louisiana local practitioner questionnaire presented in Chapter III indicate that none of the local practitioners included in the sample were completely proficient in all of the areas covered by the questionnaire. A local practitioner would appear, then, to have the moral obligation to recommend advisors to his clients in problem areas in which the local CPA is not completely competent. In many cases the advice and counsel of an outside consultant is sufficient to satisfactorily perform the required engagement, while in other cases a referee is required.

The need for a public controller often creates a need for a referee.--A major reason for referrals among local practitioners is that the desired services would entail

making management decisions by the same partner who is in charge of the audit. The need of direct management assistance is especially prevalent among small firms. It would be highly questionable if an auditor is actually independent in appearance and possibly in fact when an individual makes management decisions for the same client for whom he renders an opinion on the representation of financial statements.

Some practitioners have solved the need of small businesses for participation in financial and accounting decision making by acting as a public controller for a small firm. Such local CPA firms cooperate with another CPA firm which provides the auditing services. One local practitioner who often serves as a public controller for small businesses has found that in most cases the yearly fees for public controllership exceed those for the audit.¹

Going public often creates a need for a referee.--

Another principal reason for a referral is that a client is considering selling his securities to the general public. A tendency exists among some underwriters to suggest that the required auditing services be performed by a national accounting firm. A probable reason for the action by the underwriter is that anyone who buys securities outside of territory served by the local CPA firm will not have as much confidence in an unknown local CPA.

¹Robert K. Whipple, "Public Controllership," The Journal of Accountancy, CXXVI (September, 1968), 80.

A local practitioner who has a client going public does not necessarily have to lose a valuable client due to such action. The local practitioner may be able to work with a national firm or be the principal accountant in the filing. One examination of a number of prospectuses found "that small CPA firms and individual practitioners have a role in public offerings."¹ Many times the national CPA firm will render an opinion on the latest financial statements while the small CPA firm can report on statements of prior years.

Of course, the local practitioner, especially the larger local CPAs, could demonstrate their capabilities to perform satisfactory work to the satisfaction of the underwriters. The evidence does suggest that many local practitioners do participate in Securities and Exchange Commission filings. Andrew Barr, Chief Accountant for the Securities and Exchange Commission in 1961, stated that 363 separate accounting firms were named as the principal accountant in 1,357 separate filings in 1960, including the eight largest national accounting firms which certified 851 of the statements; 7 others served in from six to twenty filings; 15, in three to five; 51, in two each; and, 282 firms each in a single filing.² The growth of smaller firms does not

¹Mary E. Murphy, Advanced Public Accounting Practice (Homewood: Richard D. Irwin, Inc., 1966), p. 377.

²MacNeil, ed., Accounting Practice Management Handbook, p. 368.

rule out the possibility of continued service by the local practitioner who is capable and progresses along with his clients. However, the rapid growth of many clients doubtlessly contributes to the increase in size of the average Louisiana CPA firm along with the swift trend toward branch offices especially among the larger local Louisiana CPA firms.

Limited staff size may create a referral situation.—

A possible situation which calls for a referral is when the local CPA staff is not large enough to complete the assignment in a reasonable length of time. A local practitioner could solve the problem by combining staffs with other local CPAs. The combining of staffs can also be effective when a local practitioner's staff is not completely competent to perform all the phases of the assignment, but needs the assistance of qualified personnel from the staffs of other local practitioners.

A similar situation which could entail the use of staff of another practitioner or a referral is when the workload schedule is so tight that enough time is not available to start and complete all of the scheduled assignments. Such a work overload situation should call for a review of personnel requirements in order to determine if the CPA practice is being managed in an effective and efficient manner.

The data in Table 13 indicate local practitioners seldom combine staffs when performing management services work which is one of the more likely areas where such a combination might be feasible. Only approximately eight per cent of the total number of practitioners included in the survey have ever combined staffs to perform management services work.

Table 14 indicates that Louisiana local practitioners and national CPA firms seldom combine staffs in order to perform management advisory services work. The combination of staffs is an effective method of overcoming the fear of encroachment. Furthermore, joint ventures among CPAs is an effective way for a local practitioner to learn advanced techniques and procedures from his fellow professional accountants.

More cooperation among local practitioners would probably result in both a greater service to many of their clients and in a larger financial reward to the practitioners. The evidence does imply that CPAs can take positive steps to provide management services or other types of specialized services which they are not completely capable of providing if joint ventures are not entered into. The national CPA firms could offer greater assistance to the accounting profession by actively promoting joint ventures. However, no indication of any such immediate action by the national firms exists.

TABLE 13

AN ANALYSIS OF THE OCCURRENCE OF COMBINING OF
STAFFS AMONG LOUISIANA LOCAL PRACTITIONERS
FOR THE PURPOSE OF PROVIDING
MANAGEMENT SERVICES

<u>Question</u>	Percentage of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do you ever combine staffs with other local practitioners in order to perform management services work?	4	96	17	83	7	93

TABLE 14

AN INVESTIGATION OF THE OCCURRENCE OF JOINT
MANAGEMENT SERVICES VENTURES AMONG
NATIONAL CPA FIRMS AND LOUISIANA
LOCAL PRACTITIONERS

<u>Question</u>	<u>Percentage Of Occurrence Of Joint Management Services Engagements</u>	
	<u>Yes</u>	<u>No</u>
1. Do you ever engage in cooperative efforts with local CPAs for the purpose of performing management services work?	33	67

The local practitioner has a moral obligation to his client to call in a consultant or to suggest a referee when the situation warrants such an action.--The data suggest that there are many situations which are encountered by the average local practitioner which should result in the action of consulting with an expert or the recommendation of a referee. Moreover, the evidence indicates that all local CPAs regardless of size will in all likelihood encounter situations where the practitioner does not adequately possess the techniques and procedures which are required for a satisfactory completion of an assignment. In such situations the local practitioner would appear to have an obligation to his client to suggest a referee or confer with a qualified consultant depending on the specific requirements of the problem area.

The local CPA can employ various methods to supply services in areas in which he is presently not competent.--

A local practitioner can employ various methods in order to fulfill the needs of his client in an area in which the practitioner should consider obtaining the necessary skills. For example, the demand for an EDP practice is large enough to warrant the obtainment of the required EDP techniques and procedures.

Another choice available to the local CPA is to hire an outsider who is proficient in the needed specialized area provided the practitioner is able to supervise the new specialist or the specialist has the required qualifications to become a partner. Of course, the demand would have to be great enough to support the additional personnel.

An alternative available to the local practitioner is to engage the services of a fellow CPA who has greater experience and knowledge in a particular speciality area. Generally a consultant is not feasible for an assignment which requires a large staff of outside specialists.

The recommendation of another CPA firm which is competent in the needed area is another common method of securing the required services for the client. A referral is needed in many cases where the use of a consultant is not practical.

Another method of obtaining the necessary competent services for a client is to suggest that the client obtain the services of a member of another profession or a technical consultant. The recommendation of consultants outside

the accounting profession could be either in areas outside the scope of accounting or in areas where certain accounting firms are also proficient.

Of course, the local CPA can enter into joint working agreements with other professional accountants. The evidence previously mentioned indicates few practitioners actually enter into such agreements.

Referral System of Various Selected Professions

The medical profession has the most sophisticated referral machinery.--In order to more effectively analyze and evaluate the accounting referral system, a brief examination of the referral machinery of other selected professions will be presented. Professions other than accounting have established various forms of machinery in order to select a referee or consultant. The medical profession has the most sophisticated referral system. The medical profession is broken down into numerous specialty divisions. The various societies of specialists provide information geared to the needs of the specialists and also provide directories which identify the society members.

The overwhelming majority of medical doctors are specialists as only about twenty per cent of the total number of physicians are general practitioners. The specialists have the same broad background as the general practitioner, but must receive post-graduate education in their chosen specialty field. The length of the post-graduate

education varies according to the specialty, but generally lasts three years. The specialty programs at the University of Cincinnati Medical School, for example, vary from two to six years with the most programs consisting of a three year training period. Recently, the American Medical Association began promoting a new academic program for the general practitioner which would include about the same amount of time of academic hours as the average specialty areas. This effort to raise the general practitioner level to that of a recognized specialty may not be well received by some of the prospective general practitioners since it would require him to take a periodic examination for recertification.

The medical profession has felt that the developments in knowledge and techniques are so rapid that specialization is the best solution for this phenomenon. Thus, many avenues an individual can take in order to obtain a specialist for his ailment, including listings by specialty in the local telephone directory are open.

The medical doctor generally has no fear of encroachment in referrals due to the fact that boundaries of specialties do not tend to overlap. Moreover, the general practitioner can always locate a qualified specialist for his patient or consult with a qualified colleague about his patient by the means of a formal referral system which recognizes specialty areas. The medical profession also

certifies technicians who remove some of the less sophisticated routine burdens from the workload of the physician.

A form of specialization exists in the legal profession.--In the legal profession, a form of specialization exists. The fields of patent law and admiralty law are recognized as distinct fields which are separate and apart from the general practice of law. Specialists in the fields of patent law and admiralty law are not formally accredited as such by the American Bar Association. However, a patent lawyer, for example, is enrolled to practice before the U.S. Patent Office and is listed by this specialty in the telephone directory.

A trend may be seen in the legal profession for a more formal recognition of specialty areas besides patent and admiralty. A nationwide computerized listing of more than 300,000 lawyers according to various criteria is now available.¹ In this directory the lawyers are listed by such specialties as patents, antitrust, corporate, estate planning, international, labor, matrimony, real estate, and taxation. This reference to specialties is mainly based on interest rather than on the results of actual examination for competence. However, such listings are a good indication the individual lawyer has experience in such a specialty area and that his law school courses and self-

¹"National Listing of Lawyers Available," Management Services, VI (March-April, 1969), 16.

development program are aimed toward this specialized area of interest.

The American Bar Association also has specialty sections which are open to all lawyers, but the sections usually attract those who practice and are proficient in the specific specialty. Thus, a general practitioner has many avenues open to him to obtain a referee or consultant. The general practitioner is prone to utilize a consultant in areas in which he is not proficient if such a procedure is feasible. An individual can also obtain the services of a specialist by the use of a lawyer reference service. Such a reference service maintained by local bar associations is found in the larger cities.

The management consulting field is beginning to establish a formal referral system.--The management consulting field is slowly evolving toward recognition as a profession. A leading proponent for professionalization in this field for many years has been the Association of Consulting Management Engineers. The Association of Consulting Management Engineers is actually a non-profit trade association of professional management consulting firms located in North America. The management consulting association has sponsored studies in the management consulting area and also publishes a directory of member firms. The directory lists all of the member firms along with their locations, general area of service, and types of clients served.

Recently five of the principal management consulting associations sponsored the formulation of a management consulting association based on individual membership rather than firm membership.¹ The new association of individual management consultants is named the Institute of Management Consultants, Inc. The Institute of Management Consultants, Inc. began operation with approximately 140 members of whom most were well known senior consultants with established management consulting firms. The organization plans to admit a few more widely recognized consultants to membership in 1969. After 1969, all new members must take an oral and written examination before they are admitted to membership.

A similar organization has been organized in Canada and is named the Institute of Management Consultants of Ontario. The organization started giving their comprehensive examinations in 1968. The fact is noted that the present president and vice-president of the Institute of Management Consultants of Ontario are employed by two different international accounting firms.

Accounting Referral System

The accounting profession has no formal referral system.---The data points out the fact that the selected professions investigated have machinery of various degrees of

¹"New Group Formed to Set Consultant's Admission Standards," Management Services, VI (March-April, 1969), 6.

sophistication to select a referee or consultant. All of the professions studied have or will soon have a formal or informal means of indicating members who are proficient in certain selected specialized areas. However, presently no machinery is available in the accounting profession to locate qualified specialists.

The Journal of Accountancy and various other accounting periodicals published by state societies of certified public accountants are divided into sections for the discussion of specialized topics. The American Institute of Certified Public Accountants also has sections which publish technical studies according to specialized fields of interest. However, a strong opposition to specialization among the membership of professional accounting societies is appearing. The Council of the American Institute of Certified Public Accountants in recent years has declined to accept two proposals pertaining to specialization. One of the proposals was to establish sections within the American Institute of Certified Public Accountants which would be similar to that of the American Bar Association. The second proposal was to create an Academy of Professional Accounting. The purpose of the program was to encourage continuing education and admission to the Academy was based on satisfactory completion of advanced courses. The stated purpose of the Academy was not the acknowledgement of specialists, but doubtlessly the academy would have led to the recognition and identification of qualified specialists.

Many local practitioners may not approve of specialization because they perceive that it would mostly benefit the national CPA firms. A national CPA firm could conceivably have specialists in all of the various specialization categories while a local CPA would probably not be certified in all of the categories. The local CPA might believe that the lack of accreditation in all the areas of specialization might put him at a competitive disadvantage as far as his clients are concerned. On the other hand, accreditation would tend to lead to a more frequent occurrence of referrals. Progressive local practitioners who would be certified in fields with a heavy demand for such specialists should benefit by an increased demand for their services. The client of the specialists would be prone to be confident in the performance of their recognized proficient auditors. Furthermore, accreditation helps to prevent the undertaking of services for which the practitioner is not competent.

A useful referral system is an essential factor in the efficient operation of a small business.--The need for a system to identify specialists in the accounting profession is urgently needed. This want is especially apparent in the management services area. One study of management counseling of small manufacturers concluded that "a means should be provided for making available to small businesses the names of the persons, firms, and agencies which offer management

consulting service."¹ Another study of management consulting of small businesses concluded that there is a critical need for the development of a method to certify management consultants.² Furthermore, a study of small business counseling found that many of the small businessmen interviewed stressed the desire for a more satisfactory method of initiating counseling services.³

The failure of the accounting profession to seize the opportunity to certify specialists in management services, for example, has contributed to opening the door to others to provide such designation of specialists. Moreover, other organizations are beginning to provide small firms with aid in locating referrals. Several universities in the state of Ohio, for example, are presently providing assistance to small businesses by the means of locating specialists for small firms when requested to do so.

Local practitioners tend to rely upon various methods in order to select a referee.--Due to the lack of formal referral machinery, the local practitioner must resort to an informal method or methods in order to locate a practition-

¹Green, Downer, and Cerney, Case Studies in Management Counseling of Small Manufacturers, p. 169.

²Karl Morrison, Management Counseling of Small Business in the United States, (University, Mississippi: University of Mississippi, 1963), p. 202.

³Calder, Small Business Counseling: An Evaluation of Techniques, p. 32.

er to perform services in a particular specialized area. However, none of the informal methods available to the local CPA assures him that the referee will possess the necessary skills and knowledge for the assignment.

Table 15 indicates that local CPAs rely on various methods or a combination of several methods to select a referee. The data imply that personal acquaintances are the most important single factor generally used in the process of choosing a referee. Doubtlessly a local CPA who participates in professional meetings and in other professional society functions will tend to obtain more than an average share of referrals. Technical articles published in accounting periodicals will also tend to enable a local practitioner to stand on a pedestal as far as the possibility of being selected to perform future referral work.

None of the practitioners in the sample relied upon a directory of management consultants to choose a referee and only the large local firms tend to rely heavily on personal observation of prior work by others. The failure to rely on the observation of prior work by local practitioners is probably due to the relatively infrequent use of referrals in many specialized areas of accounting.

As a rule, the local CPA never relies on the advice of an outsider such as a banker or lawyer in selecting a referee. The practitioner most likely feels that he is in a better position to judge the qualifications of a professional accountant than is a member of the laity.

TABLE 15

AN ANALYSIS OF THE METHOD OR METHODS USED
BY LOUISIANA LOCAL PRACTITIONERS IN
SELECTING A REFERRAL

<u>Referral Method</u>	Percentage Of Use Of Method According To A Professional Staff Of					
	1-5		6-10		Over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Directory of Management Consultants	0	100	0	100	0	100
2. Personal observation of prior work by others	28	72	13	87	50	50
3. Suggestions by a banker or lawyer	10	90	8	92	0	100
4. Personal acquaintances	55	45	46	54	57	43
5. Rely on reputation of a local CPA firm	18	82	23	77	14	86
6. Rely on reputation of a national CPA firm	10	90	15	85	21	79
7. Other	13	87	15	85	14	86

Note: Some of the practitioners use more than one method to select a referee.

The larger local practitioners generally rely more heavily on the reputation of national CPA firms than do the smaller CPAs. Location of offices and type of services required probably account for much of the difference. Furthermore, the smaller local CPAs are more prone to place a heavier reliance on local practitioners.

A few practitioners indicated that other methods were considered when making a referral. Generally the other reasons were very similar to the general categories suggested by the questionnaire. The other reasons ranged from "CPA firms that are members of the American Institute of Certified Public Accountants" to "a member of the American Group of CPA Firms."

The data imply many practitioners are groping for methods to select qualified referees and consultants. The most frustrating point is that a method presently used to select an adequate referee does not guarantee future success.

Local practitioners seldom make referrals.--Despite the many compelling reasons for referrals, Table 16 indicates that referrals are generally an infrequent occurrence. Only approximately fifty-four per cent of the local practitioners included in the sample have ever referred work to another CPA during the entire existence of the practitioner's practice.

The smaller practitioners generally do not refer a client to a national CPA firm. One reason for such infre-

TABLE 16

INVESTIGATION OF THE FREQUENCY: (1) IN WHICH
LOUISIANA LOCAL PRACTITIONERS MAKE REFERRALS,
(2) IN WHICH REFERRALS ARE REJECTED BY LOCAL
PRACTITIONERS AND NATIONAL CPA FIRMS, AND
(3) IN WHICH ENCROACHMENTS OCCUR

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of								
	1-5			6-10			over 10		
	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1. Have you ever had the experience of referring work to another CPA who subsequently extended his services to areas formerly performed by you yourself?	12	44	44	11	39	50	0	60	40
2. Have you ever had a referral rejected by another local practitioner?	4	54	42	6	35	59	0	33	47
3. Have you ever had a referral rejected by a national firm?	2	24	74	0	29	71	0	60	40

Note: N/A is an abbreviation for no experience in this area.

quent use is probably location. However, the majority of the Louisiana sole practitioners practice in a community which has an office of a regional or national CPA firm. Another major reason for such infrequent referrals to national CPA firms is that generally many of the national firms do not appear to encourage referrals. Table 17 indicates that the national CPA firms are not usually active in explaining the types of management services they perform to local practitioners. Moreover, all of the national CPA firms included in the survey occasionally receive referrals from Louisiana local practitioners. Only one local practitioner in the sample ever had a referral rejected by a national firm. The practitioner stated the referral was rejected because the national firm was unable to perform the assignment in the necessary time period.

The larger local firms have had relatively greater experience in referrals to national CPA firms. The situation is apparently due to the fact that local CPA firms have a greater number of larger clients who operate in a broader geographical area. The larger clients create a need for a CPA firm which has offices in other states and foreign countries.

None of the larger CPA firms which have used national CPA firms as a referee have ever experienced an encroachment from the national firm. One local practitioner has suggested that the small practitioner, who is competent, need not fear referring a client to a large national firm.

TABLE 17

AN ANALYSIS OF THE FREQUENCY WHICH NATIONAL CPA
FIRMS EXPLAIN THEIR MANAGEMENT SERVICES WORK
TO LOUISIANA LOCAL PRACTITIONERS AND THE
OCCURRENCE OF REFERRALS WHICH RESULT
FROM RECOMMENDATIONS FROM LOUISIANA
LOCAL PRACTITIONERS

<u>Question</u>	<u>Percentage of Occurrence</u>		
	<u>Never</u>	<u>Occasionally</u>	<u>Frequently</u>
1. Does your firm ever receive referrals from local Louisiana practitioners?	0	100	0
2. Do you explain the type of management services you perform to local practitioners?	33	50	17

The local practitioner has had extension experience with referrals to national firms and has found that at no time during or after the engagement was there any problem with the referral firms' attempting to solicit the client.¹ The practitioner further found that his firm benefited from observing the referral firms use of more sophisticated and perfected procedures and practices.

The evidence gleaned from the national CPA firm questionnaire indicates that many of the huge firms will accept referrals from local practitioners, but are generally reluctant to extend their services to an area which is presently performed by the referring local practitioner. Table 18 is misleading due to the fact that all but one of the national firms qualified their yes answer to the extension of service question. Most of the firms which qualified their answers stated that they would extend their service only if the local practitioner agreed to such an extension. However, one firm indicated no reluctance to extend services if the conditions warranted. Another national firm stated in effect that each situation would be independently reviewed to determine whether or not an extension of services was warranted. Thus, the national CPA firms appear to have various policies pertaining to referrals. In all likelihood, many practitioners choice of a national CPA

¹Jordan L. Golding, "A Referral Experience," The Journal of Accountancy, CXIX (April, 1965), 87.

TABLE 18

AN ANALYSIS OF THE WILLINGNESS OF NATIONAL CPA
FIRMS TO BOTH ACCEPT REFERRALS FROM LOUISIANA
LOCAL PRACTITIONERS AND TO EXTEND THEIR
SERVICES BEYOND THE SPECIFIC ENGAGEMENT

<u>Question</u>	<u>Percentage Of Occurrence</u>	
	<u>Yes</u>	<u>No</u>
1. Will your firm accept referrals from local practitioners?	100	0
2. If a client requests you to extend your services to an area which is now performed by a local practitioner who referred you to the client, would you extend your services after consulting with the referring local practitioner?	83	17

firm is based on the perceived probability of encroachment. The more frequent use of local practitioners as a referee among the smaller practitioners as contrasted to a national CPA firm is doubtlessly due to such factors as reciprocity, location, personal acquaintances, and observation of prior work.

The lack of referrals is due to many factors.--The very infrequent use of referrals is due to a complex variety of interrelating factors. The principal interrelated factors causing the infrequent use of referrals appear to include such items as (1) the lack of internal information report which would point out major inefficiencies, (2) the lack of existence of a listing of qualified personnel, and (3) the lack of an effective environment which would temper the fear of encroachment.

An internal information report would point out major inefficiencies in the internal information system. Such a report would be designed to recommend referrals if conditions warranted. This type of report depends on the practitioner's possessing an adequate knowledge level in order to recognize any major problem area in the internal information system. This type of internal report would bring attention to the major areas which do require corrective action to be taken.

Lack of specialization is a major roadblock to an effective referral system.--The failure of the accounting

187

profession to recognize specialists is also a major hindrance to the use of referrals. Two kinds of specialization are to be noted. One type is specialization by client. A practitioner who only performs services for companies which are involved in the petroleum industry would be an example of specialization by client. The more common form of specialization is by type of service. The organization of many local practitioners tend to be broken down by type of service. One local CPA firm located in the state of Colorado has been organized along departmental lines for several years. The five partners are each responsible for one of the following specialized areas: (1) audit, (2) tax, (3) systems and budgeting, (4) financial advisory services, and (5) mergers and acquisitions.¹

Many local practitioners are actually specialists in practice, but no machinery is established to point out these specialists. The recognition of specialists would help to overcome the encroachment fear among local practitioners. Possibly a local practitioner would be in a position to choose an individual practitioner or a small local CPA firm which offers a limited variety of specialized services which would not conflict with the services the referring practitioner now performs for the client. Thus, there would be

¹Marvin L. Stone, "Specialization in the Accounting Profession," The Journal of Accountancy, CXXV (February, 1968), 26.

no hesitation to refer in this case.

The failure to recognize specialists prevents the local practitioner from selecting a referee from a list of competent personnel. A practitioner is able to find a referee only by some informal method which does not guarantee the referring CPA that the referee is competent in the selected area. In some cases, the local practitioner may not even be able to locate a qualified CPA although one may be available in the community.

Fear of encroachment is a major obstacle to an effective referral system.--A major obstacle to an adequate referral system in the accounting profession is the fear of encroachment. In the medical profession, for example, a general practitioner has almost no fear of a referee extending his services to areas other than that to which the patient was specifically referred. However, accounting firms offer a variety of services to clients. Thus, a professional accountant usually possesses the potentiality of extending his services to the client beyond that originally contemplated when the referral was made.

In 1957 the American Institute of Certified Public Accountants adopted Rule 18 of the Code of Professional Ethics which was later renumbered Rule 5.02. Rule 5.02 is cited below:

A member or associate who receives an engagement for services by referral from another member or associate shall not discuss or accept an extension of his services beyond the specific

engagement without first consulting with the referring member or associate.¹

The objective of this professional rule of conduct is to eliminate the fear of encroachment. One practitioner expressed the opinion that Rule 5.02 would solve the encroachment problem as he stated: "With nothing to fear, the smaller practitioners should be glad to work out a plan of cooperation with the larger accountant-management firms and the vexing problem of keeping one's clients happy without losing them will be resolved."²

Many local practitioners are hesitant to recommend a referee.--The data from the Louisiana local practitioner sample indicate that Rule 5.02 of the Code of Professional Ethics has not satisfactorily solved the problem of fear of encroachment. Table 19 indicates that a significant segment of the Louisiana local practitioners are reluctant to recommend a referee due to the perceived fear of encroachment. The significant segment includes approximately thirty per cent of the entire sample. Moreover, the data indicate that a larger segment of the sample is probably reluctant to refer due to the fact that approximately one out of two local practitioners has never recommended a referral during

¹Code of Professional Ethics and By-Laws. (New York: American Institute of Certified Public Accountants, Inc., 1967), p. 11.

²Michael D. Bachrach, "Cooperation in Services to Management," The Journal of Accountancy, CX (March, 1958), 38.

TABLE 19

AN ANALYSIS OF THE LOUISIANA LOCAL
PRACTITIONER'S RELUCTANCE TO REFER
DUE TO THE PERCEIVED FEAR
OF ENCROACHMENT

<u>Question</u>	Percentage of Occurrence According To A Professional Staff Of					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Are you reluctant to refer your client to another CPA due to the fact you perceive that he will probably extend his services to areas you now perform?	24	76	33	67	33	67

the entire existence of their practice. The fact is very questionable whether or not the practitioners were capable of providing their clients with all of the accounting services which were needed for optimum operation.

The entire circumstances surrounding the assignment is the major factor in the determination of whether or not a problem area will be reported to the client.--The reluctance to refer a client to another CPA can lead to an undesirable situation which is both detrimental to the client and to the accounting profession. The hesitation to refer can lead to the situation where a local practitioner will be prone to overlook a deficiency if he is not competent to render services in the specialized area. Table 20 indicates that most local CPA's do feel an obligation to inform their clients of problems in areas where the CPA is not proficient and refer the client to a CPA who is competent in the problem area. However, other evidence from the Louisiana local practitioner questionnaire seriously questions the response to this referral question. Thirty per cent of the local practitioners are hesitant to refer a client due to fear of encroachment and an elaboration of the question of perceived obligation to refer pertaining to management services appears to give a more representative answer to this question. Table 21 indicates that in many cases the situation tends to determine whether or not a problem area is disclosed and a referee is recommended.

TABLE 20

AN ANALYSIS OF THE PERCEIVED OBLIGATION OF
LOUISIANA LOCAL PRACTITIONERS TO POINT
OUT TO CLIENTS PROBLEM AREAS IN FIELDS
IN WHICH THE LOCAL CPA IS NOT
COMPETENT TO RENDER THE
REQUIRED SERVICES

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Assume that during the course of your audit that you noticed that your client has a problem in an area which you are not competent in. Would you feel an obligation to inform your client of the problem and refer him to a CPA who is competent in the problem area?	91	9	100	0	100	0

TABLE 21

AN INVESTIGATION OF THE ACTION GENERALLY
TAKEN BY A LOUISIANA LOCAL CPA WHO
DISCOVERS A DEFICIENCY IN THE
INTERNAL INFORMATION SYSTEM

<u>Question</u>	Type of Action Taken Expressed As A Percentage According To A Professional Staff Of											
	1-5				6-10				over 10			
	<u>AL</u>	<u>FR</u>	<u>OC</u>	<u>N</u>	<u>AL</u>	<u>FR</u>	<u>OC</u>	<u>N</u>	<u>AL</u>	<u>FR</u>	<u>OC</u>	<u>N</u>
1. If you notice during the course of your audit a deficiency in the information system for internal planning and decision making such as the failure to use the optimum combination of channels of distribution, would you inform your client about this fact?	<u>69</u>	<u>21</u>	<u>10</u>	<u>0</u>	<u>63</u>	<u>21</u>	<u>16</u>	<u>0</u>	<u>69</u>	<u>23</u>	<u>8</u>	<u>0</u>

Note: AL, FR, OC, and N are abbreviations for Always, Frequently, Occasionally, and Never, respectively.

Practitioners have diverse opinions concerning the propriety of a referee's extending his services.--The perceived fear of encroachment is certainly not a fantasy based on unsupportable facts. The actual occurrence of encroachment is frequent especially among the small local practitioners. About twenty per cent of the local CPAs with professional staffs numbering ten or less who also have made referrals have had the experience of the referee extending his services beyond the specific engagement to areas formerly served by the referring CPA. Many of the referees who had the experience of having a referee extend his services indicated that they did not make any further referrals at all after such an extension of services. Thus, the fear of encroachment appears to both hinder the making of referrals and further tends to completely prevent any future referrals by those who have experienced encroachment.

Table 22 indicates Louisiana local practitioners will accept a referral, but the local CPAs have various philosophies concerning the propriety of extending their services beyond the specific engagement. Elaborations supplied by the local CPAs indicate strong, but varying views held concerning the propriety of a referee extending his services exist. The philosophy concerning the propriety of extending services ranges the whole spectrum from no hesitation to extending services to never consider an extension of services. Many practitioners stated they would extend their services only if the referring CPA agreed.

TABLE 22

AN ANALYSIS OF THE LOUISIANA LOCAL PRACTITIONER'S
WILLINGNESS TO ACCEPT A REFERRAL AND
HIS PHILOSOPHY PERTAINING TO
EXTENSION OF SERVICES BEYOND
THE SPECIFIC ENGAGEMENT

<u>Question</u>	Type of Action Taken Expressed As A Percentage According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Will your firm accept referrals from another CPA firm?	100	0	100	0	100	0
2. If a client requests you to extend your services to an area which is now performed by the CPA firm which referred you to the client, would you extend your services after consulting with the referring CPA firm?	64	36	67	33	60	40

However, other practitioners expressed the opinion that the overall circumstances of the case would determine the future course of action. The data does suggest that the fear of encroachment can be lessened by the careful selection of a referee who is reluctant to extend services. On the other hand, an overzealous referee who continually encourages clients to switch all accounting and auditing services to referee is likely to encourage the referring CPA and his acquaintances to be hesitant to recommend a referee in the future. Of course, the selection of a referee on the basis of a favorable extension of services philosophy does not always guarantee that the client's best interest is being served.

The fear of encroachment adversely effects the accounting profession.--The fear of encroachment tends to adversely effect the accounting profession in several ways. One adverse effect of mistrust of the fellow CPA is that the suspicion tends to result in fewer referrals than would occur if the fear did not exist.

Another unfortunate effect of the fear of encroachment to the accounting profession is the process of referring a client to someone who is not a CPA. A non-CPA would be unlikely to perform a great variety of CPA type services. Thus, a non-CPA would tend to be less likely to extend his services to the other areas which are now performed by the local practitioner. However, the accounting profession

would be best served if the members of the profession would rather select a CPA over an equally competent outside consultant.

In many cases, the client is best served when the local CPA recommends another CPA to perform the required services rather than selecting someone other than a professional accountant. Generally, the referring CPA is more familiar with the major characteristics of a local CPA than he is with the vital characteristics of a non-professional accountant. Furthermore, if the problem area concerns an accounting area, a CPA generally can perform a higher level of services due to such factors as training, experience, and ability to relate interrelating factors such as the tax consequences of alternate methods.

Table 23 indicates that a significant segment of local practitioners would seriously consider a referee outside the accounting profession even when there is an equally competent CPA referee available. In fact, about eleven percent of the sample would definitely choose an outside consultant over a CPA. Generally, the local practitioners who expressed this opinion are reluctant to refer due to the fear of encroachment.

A possible further adverse effect on the accounting profession due to this hesitancy to refer is the attitude of the client concerning the CPA. A client who discovers that a CPA did not inform him of a problem area might be tempted to obtain services from non-CPAs in the future.

TABLE 23

AN ANALYSIS OF THE LOUISIANA LOCAL PRACTITIONER'S
PREFERENCE FOR A REFEREE WHEN A CPA AND AN
OUTSIDE CONSULTANT ARE EQUALLY COMPETENT

<u>Type of Referee</u>	Choice Of Referee Expressed As A Percentage According To A Professional Staff Of		
	<u>1-5</u>	<u>6-10</u>	<u>over 10</u>
1. CPA	67	56	72
2. Outside consultant	7	28	7
3. No preference	26	16	21

A change in present ethical rules would appear to encourage referrals, but the proposed change does have disadvantages.--The American Institute of Certified Public Accountants Long-Range Objectives Committee expressed the opinion that referrals will occur in frequent numbers only if the accounting profession continues "its efforts to develop rules of professional conduct which will encourage referrals by diminishing the present concern over the loss of a referred client."¹ A possible constructive change in Rule 5.02 might be to insert a clause which would prevent a practitioner from extending his services beyond the specific engagement except with permission from the referring practitioner.

A Canadian professional accounting society has had experience with such a professional code which specifically prevents extension of services. Rule 49 of The Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario states as follows: "No member who receives an engagement for services by referral from another public accountant shall provide any other services to the referring accountant's client without the consent of the referring accountant."²

¹Robert M. Trueblood, et al. Profile of the Profession: 1975-Vol. II (New York: American Institute of Certified Public Accountants, Inc., 1965), p. 530.

²A. I. Cole, "Professional Co-operation in Referrals," The Canadian Chartered Accountant, LXXXIX (November, 1966), 342.

The Councils of the English, Scottish, and Irish Institutes of Chartered Accountants have recently issued a joint statement which pertains in part to referrals.¹ The suggestion is made, for example, that a consultant communicate with the firm's regular auditors before accepting an engagement, plus, periodically advising the incumbent auditors of the nature and progress of the work. Provisions of the joint statement also prohibit the solicitation of work which is presently provided by another practitioner. Furthermore, if a practitioner loses work to a consultant, the consultant bears the burden of proving that the services were not attracted from the existing accountant.

The advantages of a clause which prevents extension of services without permission is that it would generally tend to overcome the perceived fear of encroachment. One leading practitioner expressed the opinion that referrals will never "achieve their full potential without a rule barring the referred accountant from accepting an engagement from the client without the consent of the referring accountant."²

Such an absolute ethical restriction code would also tend to encourage the local practitioner to select the best

¹"Chartered Accountants Issue Management Services Statement," The Journal of Accountancy, CXXIX (January, 1970), 8-10.

²J. S. Seidman, "The Obstacle to the Full Development of Referrals to Other Accountants," The New York Certified Public Accountant, XXXIII, (November, 1963), 754.

qualified referee rather than ever being susceptible to the pressure of selecting a CPA mainly on the basis of his policy of not extending services. Such a proposed absolute ethical restriction rule would encourage a more frequent use of referrals to help solve small business problems.

A disadvantage of a professional rule of conduct which prevents extension of service without permission is that the ethical rule does tend to prevent free competition. Table 24 indicates that the local practitioners are divided among themselves as to the propriety of extending Rule 5.02. A few practitioners did reply they were satisfied with Rule 5.02, but then expressed the opinion the profession would best be served by amending the present referral clause.

A written agreement not to compete is a possible alternative to an absolute ethical restriction rule.--A possible alternative to the proposed extension of Rule 5.02 is the use of a written agreement with the referee to the effect not to extend services beyond the specific engagement. Some accounting authorities suggest that this type of alternative action may be more effective in solving the encroachment problem.¹ Table 25 indicates few local CPAs enter into written agreements not to extend services beyond specific agreements. Only approximately ten per cent of the local practitioners who make referrals ever enter into

¹John L. Carey and William O. Doherty, Ethical Standards of the Accounting Profession (New York: American Institute of Certified Public Accountants, Inc., 1966), p. 14.

TABLE 24

AN ANALYSIS OF THE LOUISIANA LOCAL PRACTITIONER'S PRESENT
SATISFACTION WITH PROFESSIONAL CODE OF ETHICS RULE 5.02
AND THEIR OPINION AS TO THE PROPRIETY OF ALTERING
RULE 5.02 WITH AN ABSOLUTE ETHICAL
RESTRICTION CLAUSE

<u>Question</u>	Opinion Expressed As A Percentage According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Rule 5.02 of the Code of Professional Conduct states that "a member or associate who receives an engagement for services by referral from another member or associate shall not discuss or accept an extension of his services beyond the specific engagement without first consulting with the referring member or associate." Do you believe that this rule adequately protects a CPA firm from encroachment by a referred firm?	68	32	63	37	60	40
2. Would you be in favor of changing Rule 5.02 to prevent one who receives an engagement for services by referral from extending his services beyond the specific engagement?	51	49	37	63	40	60

TABLE 25

AN ANALYSIS OF THE USE OF WRITTEN AGREEMENTS
AMONG LOUISIANA LOCAL PRACTITIONERS NOT TO
EXTEND SERVICES IN REFERRAL ENGAGEMENTS

<u>Question</u>	Occurrence Of Written Agreements Not To Compete Expressed As A Percentage According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>Over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do you ever enter into agreements with a firm to whom you have referred a client "not to extend services?"	8	92	0	100	22	78

Note: Forty-four per cent, fifty per cent, and forty per cent of the local practitioners with professional staffs of 1-5, 6-10, and over 10, respectively have never made a referral. Thus, the percentages expressed in this Table do not pertain to the practitioners who have never made a referral.

such written agreements. A few practitioners did state that they do have a verbal understanding not to extend services beyond the specific assignment.

Table 26 indicates that most national CPA firms will enter into agreements not to extend services. However, one national firm did qualify their answer to state that perhaps they would consider such a written agreement.

Regardless of whether or not an agreement not to compete is entered into a definite written agreement on the arrangements and scope of the referral should be a standard part of a referral. The importance of such an agreement pertaining to the referral assignment is emphasized as one practitioner stated that "there must be a definite agreement on the arrangements for the referral."¹

A referral agreement establishes the scope of the engagement and helps to prevent misunderstandings between the referring firm and the referee. Furthermore, such an agreement helps to limit legal liability. It has been suggested that referral agreements contain provisions in such areas as (1) fees, (2) definition of areas of responsibility concerning the sharing of segments of the assignment if applicable, (3) arbitration of differences, (4) decision making procedures, (5) manner and method of accounting for any joint venture, (6) procedures for possible renegotiation

¹Jack O. Spring, "CPA's Services to Management," The Texas CPA, XXXII (May, 1960), 33.

TABLE 26

AN INVESTIGATION OF THE WILLINGNESS OF NATIONAL
CPA FIRMS TO ENTER INTO WRITTEN
AGREEMENTS NOT TO COMPETE

<u>Question</u>	Occurrence Of Willingness To Enter Into Written Noncompetitive Agreements Expressed As A Percentage	
	<u>Yes</u>	<u>No</u>
1. Will you ever enter into agreements with local practitioners who referred work to you "not to extend services?"	67	33

of certain provisions and terms, and (7) any other clause deemed desirable.¹

The client's best interest is the major objective of a referral system.--The paramount concern of a referral system is whether or not the system serves the client's best interest. Ideally, the client should be able to choose at will whatever practitioner he desires. Furthermore, a client also deserves to be informed about problem areas and a referee recommended or consultant provided for if the local practitioner is not completely competent to perform services in the problem area.

The weight of the evidence indicates that the overall best interest of the client is not presently being served. Almost fifty per cent of the local practitioners

¹Arthur M. Sargent, "Referrals," The Journal of Accountancy, CXVI (July, 1963), 44.

have never made a referral to a CPA despite the fact that the average small business is not operated in an optimum manner plus the fact that the average local practitioner in the sample is generally deficient in several specialized areas. Moreover, a significant number of local CPAs are reluctant to refer a client to another CPA due to a perceived fear of encroachment. The perceived fear of encroachment is based on solid ground due to the fact that almost one out of six of the practitioners who have made referrals have had the experience of the referee extending his services beyond the specific engagement. The fear of encroachment presently has led to the situation where referrals are only made infrequently, if at all, and many times deficient areas whose solution lies beyond the present skills of the practitioner are overlooked.

An absolute ethical clause would tend to create a more favorable environment for referrals.--Ideally the process of making referrals should rest on a foundation of mutual trust and understanding. However, the present system of voluntary use of limit agreement letters and reliance on mutual trust and confidence are not providing the client with a great deal of effective consulting aid. The evidence suggests that a change in Rule 5.02 to the effect that encroachment is forbidden by ethical rules probably would increase the occurrence of referrals. This absolute ethical restraint clause would hinder the clients

freedom of choice, but the rule should provide the client with needed advice and assistance. The overall best interest of the client would appear to be better served by the means of providing needed advice and assistance with the aid of a referee even though such an action would hinder the client's freedom of choice. Furthermore, Rule 5.02 does not create a situation where the client always has a complete freedom of choice. The data suggest that presently the client's freedom of choice is occasionally completely hindered by oral and written agreements entered into by CPAs.

The freedom of choice of the client would not be completely hindered by an absolute ethical restriction rule. A client can always ask the local practitioner to waive the ethical restriction code if the proprietor feels his practitioner is incompetent. The practitioner can always refuse to waive his rights, but doubtlessly the action would be rare since the client could ask another practitioner to perform the regular accounting and auditing services.

A restrictive referral clause is certainly not the ideal type of a professional ethics code. However, such an absolute restrictive ethical code appears to create the most favorable environment for the encouragement of referrals. The accounting profession is unique in some aspects as contrasted with such professions as medicine in that most accounting firms offer many overlapping services. Thus, generally the potential for encroachment always exists. A restrictive referral clause appears to be the most effective

medium to promote mutual trust in the referral process. Such an absolute ethical restriction code would protect the competent practitioner, while the incompetent practitioner does not have an indestructable shield to hide behind.

Forwarding Fees

Forwarding fees are given by a few local practitioners.--A problem which is associated with referrals is the use of forwarding fees. Rule 3.04 of the Code of Professional Ethics prevents the payment of or the receiving of a forwarding fee to or from the laity provided no services were rendered except for selecting the referee. On the other hand, forward fees may be paid to other members of the accounting profession regardless of whether or not any services were rendered. The complete text of Rule 3.04 is as follows:

Commissions, brokerage, or other participation in the fees or profits of professional work shall not be allowed or paid directly or indirectly by a member or associate to any individual or firm not regularly engaged or employed in the practice of public accounting as a principal occupation.

Commissions, brokerage, or other participation in the fees, charges or profits of work recommended or turned over to any individual or firm not regularly engaged or employed in the practice of public accounting as a principal occupation, as incident to services for clients, shall not be accepted directly or indirectly by a member or associate.¹

¹Code of Professional Ethics and By-Laws, p. 10.

Table 27 indicates that a few local practitioners give and/or receive forwarding fees. However, only one firm receives and/or gives a forwarding fee as a courtesy for referring the client with no other professional services provided. The other practitioners receive and/or give forwarding fees based upon the division of service or responsibility. The forwarding fee was based upon the services connected with the combination of staffs or providing partial auditing services pertaining to branches and subsidiaries located in geographical areas not conveniently accessible to the primary auditor. A more detailed presentation of the breakdown of reasons for forwarding fees is presented in Appendix B. All of the practitioners indicated the forwarding fee did not result in a higher total bill for the client. A more detailed presentation of this data is also presented in Appendix B.

Rule 3.04 contains a potentially harmful clause.--

Rule 3.04 contains a potentially harmful clause in that it does not require joint services to be rendered among CPAs in order for a practitioner to receive and/or give a forwarding fee. Such a clause could lead to the situation where referrals are based on the amount of the referral fee rather than on the basis of selecting the most suitable referee for the client. Even if such a situation never actually develops, the accounting profession can always be

TABLE 27

ANALYSIS OF THE FREQUENCY OF RECEIVING
AND/OR GIVING OF FORWARDING FEES AMONG
LOUISIANA LOCAL PRACTITIONERS

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do you ever give and/or receive forwarding fees from CPA firms for re- ferral services?	12	88	11	89	22	78

Note: Forty-four per cent, fifty per cent, and forty per cent of the local practitioners with professional staffs of 1-5, 6-10, and over 10, respectively, have never made a referral. Thus, the percentages expressed in this Table do not pertain to practitioners who have never made a referral.

a target for criticism based on the possible occurrence of such a situation.

The evidence gleaned from the Louisiana local practitioner questionnaire indicates that referrals not based on services is very rare. However, a future change in the frequency of referrals can always create an environment which might prove detrimental to the client.

The fact is noted that most professions forbid forwarding fees when they are not based upon a division of service or responsibility. The Association of Consulting Management Engineers, for example, has an ethical code which forbids non-service forwarding fees. Their code of ethics states that, "We will neither accept nor pay fees to persons outside our firm for referral of clients."¹

In order to prevent any actual or perceived harm to the client and the accounting profession, it is proposed that Rule 3.04 be changed to forbid any receiving and/or giving of forwarding fees except based upon a division of service or responsibility. Such a proposed professional rule of ethics should help to promote a sense of professional integrity and prevent any action which is detrimental to the best interests of the client.

¹Directory of Membership and Services--1968-1969,
(New York: Association of Consulting Management Engineers,
Inc., 1968), p. 69.

Conclusions

A local practitioner seldom recommends that his client hire a referee.--The data imply that practitioners seldom consult with a specialist or recommend a referee be obtained despite the fact that all of the practitioners included in the sample were not completely competent in all of the various common body of knowledge categories listed in the questionnaire. Moreover, most small businesses are in need of competent advice and assistance in various specialized areas in order to operate in an optimum manner. In fact, only about fifty per cent of the Louisiana local practitioners have ever made a referral despite the most probable occurrence of many situations for which a referral is called.

Various interrelated factors tend to discourage referrals. The major factors hindering referrals appear to be (1) the fear of encroachment, (2) the lack of accreditation of specialists, and (3) the lack of an internal information report. The consequences of the failure to recommend a referee tends to adversely effect the best interest of the client and the accounting profession. A major segment of the local practitioners expressed the opinion that they are reluctant to refer their clients to another CPA due to the perceived fear of encroachment. Furthermore, some practitioners will tend to overlook problem areas in fields in which they are not competent rather than select a referee

to perform the necessary services. This reluctance to point out problem areas and to subsequently recommend a referee hinders the orderly development of both the accounting profession and the client.

Several steps can be taken to improve the accounting referral system.--The fear of encroachment is a major factor which discourages referrals. The actual occurrence of encroachment is quite obvious to most practitioners since approximately one out of six practitioners who have made referrals have had the experience of a referee extending his services beyond the specific engagement. This percentage of actual encroachment is significantly higher among the smaller local practitioners.

The data suggest that the addition of an absolute ethical restraint clause to the Code of Professional Ethics would create a more favorable environment for referrals. The proposed ethical rule would tend to promote referrals among CPAs rather than continuing the present practice of tending to refrain from recommending a referee.

The disadvantage of such an absolute ethical restrictive code is the hindrance of the client's freedom of choice. Ideally, referrals should be based on mutual trust and confidence. However, the various overlapping services provided by the accounting practitioners creates a situation where the referee almost always possesses the potentiality to extend his services. Although the proposed ethical

rule will tend to hamper the client's freedom of choice, the proposed code does not require that a client retain the services of an incompetent practitioner. Furthermore, improvement in the frequency of referrals and resulting correction of the many problem areas appears to support the absolute ethical restrictive code as being in the best interest of the client. Moreover, the present ethical rule in many cases permits the actual restriction of the client's freedom of choice by the means of oral and written agreements not to compete.

The problem of the fear of encroachment will probably never be completely solved due to the peculiar nature of the accounting profession. Furthermore, the proposed ethical restrictive rule would not completely solve the present problems in the referral system. The accreditation of specialists would create a formal listing of qualified personnel. An internal information report would point out on a systematic basis the major problem areas which need correction. Thus, a combination of an absolute ethical restrictive rule, a formal listing of qualified referees and consultants, and an internal information report pointing out major problem areas would create a most favorable environment for an efficient and effective referral system. Furthermore, a change in the ethics clause forbidding the giving and/or receiving of forwarding fees among CPAs except for services rendered or responsibility shared would tend to eliminate the possibility of referrals based mainly on the

amount of the forwarding fee rather than based on the actual overall qualifications possessed for the required assignment.

The absolute ethical restrictive clause is a type of action that can be taken in a relatively short period of time. Any action concerning specialization and/or an internal information report would take a longer period of time due to the necessity to develop rules, procedures, and regulations. Thus, the absolute ethical restrictive clause has the potentiality to having the greatest short run effect of creating a more favorable environment for referrals.

Presently, the local practitioner can best obtain referrals by a continuous self-development program, participation in accounting professional and social activities, being prudent in the extension of services, and participation in joint engagements. However, the competent local CPA could doubtlessly participate in a larger number of referrals if the accounting profession would create a more favorable referral environment.

CHAPTER VI

AN ANALYSIS AND EVALUATION OF THE PROFESSIONAL DEVELOPMENT PROGRAMS OF LOUISIANA LOCAL PRACTITIONERS

Effect of Knowledge Explosion

The knowledge explosion is having an immense effect on the local practitioner.--The purpose of the chapter is to investigate and examine the professional development programs of Louisiana local practitioners. The examination of continuing educational programs will place emphasis on the areas where improvements can be made in order to increase the effectiveness of the average local CPA.

Knowledge is no longer increasing at a slow and steady pace. The knowledge explosion is unyielding and is increasing at an ever swifter rate. The rapid growth of knowledge is demonstrated by the fact that knowledge gained in the remainder of this century will probably come close to equaling the sum of the entire knowledge which has evolved from creation to present.

Most of the prominent educators agree that the general knowledge level is increasing at the rate of approximately ten per cent per year with a significantly higher

percentage of knowledge explosion in selected technical fields. The fact has been forecasted, for example, that a graduate engineer must spend ten per cent of his time each year extending his knowledge in order to remain on the same level as current graduates.¹ Furthermore, the knowledge extension must reach approximately twenty per cent for an engineer to remain of equal value to his employer and society. Another education authority expresses the opinion that the knowledge gained through the formal educational process has a half-life of approximately seven years.² Thus, in seven years half of the knowledge gained at the time of graduation will be obsolete. If a professional career is expected to last forty-two years, the fact can be noted that only an extremely small fraction of the knowledge originally gained in a formal educational degree program is of any value. In effect, a professional man who does not have an adequate professional development program becomes obsolete at a very fast rate. Moreover, the unequivocal statement can be made that the knowledge explosion is omnipresent and unrelenting.

The effect of the knowledge explosion is being felt by every practitioner. The knowledge explosion has not gone without recognition by members of various professions. One

¹"The Rising Crisis in Skills: More Jobs Than Skills," Steel, September 7, 1964, p. 58.

²J. Stuart Johnson, "The Mark of An Educated Man," Phi Kappa Phi Journal, XLVII (Fall, 1968), 34.

study of 2,000 managers in the metal industry found that forty-two per cent of the executives expressed fears about their ability to keep up with the advancing technology.¹ However, a member of a profession such as accounting has a duty to advance along with the development of sophisticated techniques and procedures in his field. A professional accountant must adapt to the changing environment. Any major resistance to constructive change is not a desirable characteristic of a member of a dynamic profession.

The knowledge explosion has resulted in a revolutionary change in the educational process. No longer is a college education an end in itself because it is the finishing step of a professional accountant's preparation for the profession. The education of a professional accountant is a continuous life-long process.

The knowledge explosion creates a need for imaginative educational programs.--The education gap created by the knowledge explosion emphasizes the need for highly innovative educational programs. Universities, professional accounting societies, and the individual CPA all have an important role to play in the development and growth of the professional accountant. Universities are changing their curriculum in order to prepare the accounting graduate more effectively for the ever increasing complex and sophisti-

¹"The Rising Pressures to Perform," Time, July 18, 1969, p. 75.

cated duties of a professional accountant. The accounting students are now being exposed to more courses in such sophisticated areas as quantitative techniques and computer science. Furthermore, the accounting profession has begun to recognize the fact that the traditional four year formal educational program is no longer sufficient in scope to meet the educational needs of a professional accountant. The American Institute of Certified Public Accountants Committee on Education and Experience Requirements of CPAs concluded that "the mastery of the body of knowledge which is commensurate with our public responsibility will require not less than five years of collegiate study."¹ Furthermore, the Council of the American Institute of Certified Public Accountants recently suggested that by 1975 the states should adopt a five year educational requirement.²

The five year educational program will be a major step in the direction of enabling the new accountant to possess the minimum common body of knowledge required to satisfactorily perform the duties of a beginning professional accountant. Other professional accounting societies are also offering various continuing educational programs to aid in upgrading the practicing CPAs.

¹Academic Preparation for Professional Accounting Careers, pp. 1-2.

²"Council Approves Policy Requiring Five Years of College Study," The CPA, XLIX (June, 1969), 4.

Review of Professional Development Program

The average local practitioner has a weak professional development program.--Table 28 indicates that formal educational courses usually tend to play a less significant role than self development and formal professional development courses in the obtainment of the practitioners present knowledge level. This phenomenon is doubtlessly due to the fact that many of the knowledge areas listed in the Louisiana local practitioner questionnaire pertain to recent developments in the tools of the trade. Thus, the knowledge areas were developed after the average local practitioner had completed his formal educational courses. Moreover, since most universities do not offer continuing educational courses designed primarily for the practicing accountant, the local CPA had little or no opportunity to use university facilities.

The data do strongly support the idea that education is a life-long process, and that continuing education is a must in order for a professional accountant to remain in a position to offer his clients a high level of professional services. The data further indicate that an inadequate continuing education program can lead to the situation where the local CPA is not able to perform many of the more sophisticated services offered by the progressive CPA.

The evidence suggests that a direct and positive relationship exists between an adequate professional develop-

ment program and sufficient common body of knowledge.--A

detailed analysis of both the common body of knowledge data presented in Chapter III, the professional development data presented in Table 28, and the frequency of attendance of professional development courses as shown in Table 29 indicates that a direct and positive relationship exists between competency and an adequate professional development program.

The data imply that professional development courses generally play a major role as a method of obtaining and maintaining the knowledge base of the partners of the larger CPA firms. On the average the professional development courses play increasingly less significant roles as a method of obtaining knowledge as the size of the professional staff decreases. Furthermore, the overall knowledge level tends to decrease in direct proportion to the size of the professional staff.

Further analysis of the participation in professional development courses suggests that attendance by professional staff size is not uniform. The average attendance figures for those who have attended professional development courses indicates that in some cases the totals are distorted by a few very active practitioners. For instance, seventy-one per cent, fifty-six per cent, and twenty-three per cent of partners with professional staffs numbering from one to five, six to ten, and over ten, respectively, have attended five or less professional development courses in

TABLE 28

ANALYSIS OF THE METHODS EMPLOYED BY LOUISIANA LOCAL
PRACTITIONERS TO OBTAIN KNOWLEDGE IN SELECTED AREAS

Knowledge Area	Method Of Obtaining Knowledge Expressed As A Percentage According To Professional Staff Of											
	1-5				6-10				over 10			
	UN	PD	SD	NA	UN	PD	SD	NA	UN	PD	SD	NA
COMPUTER SCIENCE												
3. Computer language such as COBOL	<u>2</u>	<u>11</u>	<u>22</u>	<u>65</u>	<u>17</u>	<u>22</u>	<u>17</u>	<u>50</u>	<u>13</u>	<u>33</u>	<u>67</u>	<u>20</u>
4. Computer system hardware controls	<u>0</u>	<u>13</u>	<u>26</u>	<u>61</u>	<u>17</u>	<u>11</u>	<u>22</u>	<u>56</u>	<u>7</u>	<u>33</u>	<u>67</u>	<u>20</u>
5. Controls outside the computer	<u>4</u>	<u>24</u>	<u>30</u>	<u>46</u>	<u>17</u>	<u>11</u>	<u>44</u>	<u>39</u>	<u>7</u>	<u>39</u>	<u>73</u>	<u>14</u>
7. Elements of a computer system design	<u>2</u>	<u>17</u>	<u>46</u>	<u>46</u>	<u>11</u>	<u>22</u>	<u>33</u>	<u>39</u>	<u>13</u>	<u>33</u>	<u>52</u>	<u>27</u>
8. Flow charting	<u>20</u>	<u>20</u>	<u>37</u>	<u>28</u>	<u>11</u>	<u>22</u>	<u>44</u>	<u>28</u>	<u>20</u>	<u>33</u>	<u>46</u>	<u>20</u>
11. Main components of a computer system	<u>0</u>	<u>18</u>	<u>30</u>	<u>52</u>	<u>11</u>	<u>22</u>	<u>44</u>	<u>33</u>	<u>13</u>	<u>27</u>	<u>59</u>	<u>33</u>
23. Use of test decks in audit- ing a computer system	<u>0</u>	<u>9</u>	<u>26</u>	<u>65</u>	<u>6</u>	<u>11</u>	<u>22</u>	<u>61</u>	<u>20</u>	<u>39</u>	<u>46</u>	<u>20</u>
TAXATION												
20. Taxation of individuals . .	<u>45</u>	<u>22</u>	<u>87</u>	<u>0</u>	<u>28</u>	<u>33</u>	<u>89</u>	<u>0</u>	<u>46</u>	<u>59</u>	<u>99</u>	<u>0</u>
21. Taxation of corporations .	<u>45</u>	<u>22</u>	<u>87</u>	<u>0</u>	<u>28</u>	<u>33</u>	<u>89</u>	<u>0</u>	<u>46</u>	<u>52</u>	<u>99</u>	<u>0</u>
22. Taxation of trusts	<u>24</u>	<u>15</u>	<u>76</u>	<u>7</u>	<u>17</u>	<u>11</u>	<u>94</u>	<u>6</u>	<u>46</u>	<u>39</u>	<u>93</u>	<u>7</u>
OTHER ACCOUNTING AREAS												
1. A.P.B. opinions	<u>9</u>	<u>9</u>	<u>83</u>	<u>4</u>	<u>22</u>	<u>6</u>	<u>83</u>	<u>6</u>	<u>20</u>	<u>13</u>	<u>93</u>	<u>0</u>
2. Capital budgeting	<u>33</u>	<u>0</u>	<u>67</u>	<u>24</u>	<u>17</u>	<u>11</u>	<u>72</u>	<u>22</u>	<u>20</u>	<u>7</u>	<u>59</u>	<u>14</u>
6. Direct costing	<u>43</u>	<u>4</u>	<u>48</u>	<u>15</u>	<u>50</u>	<u>0</u>	<u>44</u>	<u>17</u>	<u>33</u>	<u>20</u>	<u>67</u>	<u>7</u>

TABLE 28 (Continued)

Knowledge Area	Method Of Obtaining Knowledge Expressed As A Percentage According To Professional Staff Of											
	1-5				6-10				over 10			
	UN	PD	SD	NA	UN	PD	SD	NA	UN	PD	SD	NA
18. Professional code of ethics	<u>13</u>	<u>22</u>	<u>74</u>	<u>0</u>	<u>17</u>	<u>22</u>	<u>78</u>	<u>0</u>	<u>13</u>	<u>27</u>	<u>87</u>	<u>0</u>
19. Statistical sampling methods	<u>35</u>	<u>9</u>	<u>43</u>	<u>22</u>	<u>50</u>	<u>0</u>	<u>50</u>	<u>22</u>	<u>33</u>	<u>33</u>	<u>67</u>	<u>14</u>
PERIPHERAL AREAS												
9. Linear programming	<u>4</u>	<u>4</u>	<u>14</u>	<u>78</u>	<u>11</u>	<u>6</u>	<u>6</u>	<u>83</u>	<u>7</u>	<u>20</u>	<u>46</u>	<u>33</u>
10. Macroeconomic theory . . .	<u>11</u>	<u>2</u>	<u>9</u>	<u>78</u>	<u>6</u>	<u>6</u>	<u>0</u>	<u>88</u>	<u>13</u>	<u>7</u>	<u>20</u>	<u>59</u>
12. Microeconomic theory . . .	<u>11</u>	<u>2</u>	<u>9</u>	<u>78</u>	<u>6</u>	<u>6</u>	<u>0</u>	<u>88</u>	<u>13</u>	<u>7</u>	<u>20</u>	<u>59</u>
13. Organization theory	<u>26</u>	<u>4</u>	<u>37</u>	<u>43</u>	<u>22</u>	<u>0</u>	<u>39</u>	<u>44</u>	<u>13</u>	<u>13</u>	<u>52</u>	<u>33</u>
14. Principles of human relations	<u>28</u>	<u>7</u>	<u>63</u>	<u>15</u>	<u>28</u>	<u>0</u>	<u>72</u>	<u>11</u>	<u>27</u>	<u>20</u>	<u>46</u>	<u>20</u>
15. Principles of finance . . .	<u>70</u>	<u>0</u>	<u>65</u>	<u>2</u>	<u>56</u>	<u>17</u>	<u>50</u>	<u>0</u>	<u>80</u>	<u>20</u>	<u>33</u>	<u>0</u>
16. Principles of management .	<u>45</u>	<u>4</u>	<u>59</u>	<u>7</u>	<u>61</u>	<u>17</u>	<u>50</u>	<u>0</u>	<u>67</u>	<u>20</u>	<u>59</u>	<u>0</u>
17. Principles of marketing . .	<u>50</u>	<u>2</u>	<u>43</u>	<u>13</u>	<u>61</u>	<u>6</u>	<u>44</u>	<u>11</u>	<u>80</u>	<u>7</u>	<u>27</u>	<u>0</u>

Note: UN, PD, SD, and NA are abbreviations for University Course, Professional Development Course, Self Development, and No Knowledge In This Area, respectively. The percentages sometimes equal more than one hundred per cent due to the fact that some practitioners use more than one method of obtaining knowledge.

TABLE 29

AN ANALYSIS OF THE FREQUENCY OF PARTICIPATION
IN PROFESSIONAL DEVELOPMENT COURSES
BY LOUISIANA LOCAL PRACTITIONERS

<u>Question</u>	Occurrence Expressed As A Percentage And Numerical Figure According To A Professional Staff Of								
	1-5			6-10			over 10		
	<u>Yes</u>	<u>No</u>	<u>Num.</u>	<u>Yes</u>	<u>No</u>	<u>Num.</u>	<u>Yes</u>	<u>No</u>	<u>Num.</u>
1. Have you ever attended any professional development courses?	85	15		89	11		87	13	
2. If the answer to the question is yes, how many courses have you attended?			5			7			13

Note: Num. is an abbreviation for the total number of professional development courses attended.

their entire professional career. The data does indicate that formal professional development courses play a minor role in the career plans of many local practitioners, especially those local CPAs who have small practices. A large segment of the partners of the larger CPA firms are very active in participating in professional development courses which accounts in part for their higher level of knowledge of modern techniques and procedures.

A detailed analysis of the data does overwhelmingly suggest that the knowledge of modern procedures and techniques is heavily dependent upon the adoption of an adequate professional development program. Furthermore, the evidence suggests that the more competent CPA firms tend to put much more emphasis on continuing educational programs than do the practitioners who are weak in modern methods and skills.

Professional Development Courses

A variety of accounting professional development courses are offered to local CPAs.--The American Institute of Certified Public Accountants belatedly began their formal professional development program in 1954 with an initial offering of three continuing education courses. The professional development program has slowly evolved into an offering of a broad range of courses. A selected sampling of a variety of subjects offered during the fall/winter period of 1968-69 include: Workshop on Individual Income

Tax Returns; Workshop on Corporate Income Tax Returns; Fifth Annual Tax Lecture Series; An Introduction to ADP; Auditing of EDP Installations; Auditape System Workshop; Effective Communication; Staff Training Program-Level II; Training Program for In-Charge Accountants; Management for Results; Filings with the SEC; Hospital Accounting and Medicare Audits; Tax Research Methods and Techniques; and, Building an Accounting Practice.¹ The above listing is only an example of the type of professional development courses available during a segment of a particular year. The American Institute's entire professional development program includes some courses which are not noted above. Moreover, additional courses are continually in the process of being developed.

The participation in continuing educational programs is increasing at a swift rate.--The enrollment in accounting professional development courses has grown at a rapid pace. More than twenty-five thousand practitioners are expected to participate in the American Institute of Certified Public Accountants professional development courses in 1969.² The 1969 enrollment compares with about two thousand in 1959 and

¹Professional Development: Fall/Winter 1968-69 Courses, Lecture Programs, Training Programs, (New York: American Institute of Certified Public Accountants, Inc., 1968), pp. 1-8.

²Professional Development-1969, (New York: American Institute of Certified Public Accountants, Inc., 1969), p. 2.

approximately seventeen thousand in 1965. Despite an approximate ten fold increase in participation in professional development courses in the last eight years, spokesmen for the American Institute of Certified Public Accountants state that the program is still reaching only a small percentage of the potential market.¹

Professional development courses are offered in many broad areas.--Various types of professional development programs are offered by the American Institute of Certified Public Accountants. The programs consist of seminars, lecture programs, courses, training programs, and individual study programs.

The general types of training aids cover such broad areas as accounting and auditing, taxation, practice management, management services, and data processing. During 1967 the total participation in professional development courses expressed as a percentage by general area included: 40.3 per cent in taxation; 20.8 per cent in data processing; 20.5 per cent in accounting and auditing; 10.4 per cent in staff training; 5.4 per cent in practice management; and, 2.6 per cent in management advisory services.²

¹"Professional Development," The CPA, XLVIII (May, 1968), 11.

²Achieving the Profession's Objectives: 1968 Report of Council to the Membership of the American Institute of Certified Public Accountants (New York: American Institute of Certified Public Accountants, Inc., 1968), p. 27.

Further noted is the fact that the relatively low demand for professional development courses in the area of management advisory services had not increased significantly since 1960. The disinterest exhibited in management services courses is no doubt a major contributing factor to the relatively infrequent rendering of services in this area by Louisiana local CPAs.

The professional development programs vary as to location, cost, and length, but they generally are completed in a week or less. Many state societies also offer professional development courses which compliment and supplement the American Institute of Certified Public Accountants continuing educational courses.

Various types of professional development courses are designed for specific markets.---The various types of continuing educational programs developed by the American Institute of Certified Public Accountants have the objective of partially satisfying the educational needs of a target market. The seminars are designed for small groups and are made available to state societies or local chapters for presentation. The lecture programs are designed for large groups and are generally co-sponsored by the American Institute of Certified Public Accountants and state societies. Courses, on the other hand, pertain to a broader and more specialized subject. Courses usually cover a period of two days.

A comprehensive staff training program is an effective and efficient method of training staff members.--At present the American Institute of Certified Public Accountants has initiated comprehensive staff training programs. The comprehensive staff training program is now comprised of six levels, including advanced programs which are currently being developed.¹ The first course is for recent college graduates and lasts ten and one-half days. The course covers such topics as audit reports, internal control, work paper preparation, audit techniques and procedures, taxes, professional interest and attitude, estimation sampling, systems flowcharting, and communication.

The second staff training program is geared to a staff member with one or two years of on-the-job experience. The course lasts five and one-half days. The training program covers such subjects as preparation of an audit program, workpaper preparation, internal control, tax research, program flowcharting, professional ethics, and oral and written communications.

The third level staff training program covers a period of five and one-half days. The training program is geared to specialized areas of interest. For instance, a staff member would have a choice of taking an entire course in the area of taxes, management advisory services, or gen-

¹Staff Training Program-Level I, (New York: American Institute of Certified Public Accountants, Inc., 1969), p. 1.

eral practice. Levels four and five make available advanced training in each of the specialized areas. The sixth course provides training and guidance in the area of CPA practice management. Training programs are also available which are designed for higher level staff members.

The current cost of these programs including room, board, and tuition ranges from \$375 to \$275. In all likelihood, the cost of such training programs could be recovered many times over by the performance of a higher level of service by the staff member.

Formal staff training programs should be supplemented by local training programs.--The American Institute of Certified Public Accountants Staff Training Program by itself is not a sufficiently complete educational aid. The local practitioner must also play an important role in the staff members' overall training program. One small CPA firm's staff training program, in addition to the American Institute's training courses, consists of the following steps: (1) use of a staff manual to familiarize the staff member with the firm's total organization; (2) use of the process of proof reading and filing of tax service documents to familiarize the staff member with procedures and research aids; (3) keeping a set of small books in order to understand the flow of information; (4) assigning of a variety of work according to the member's capabilities; (5) assigning required reading lists; (6) assigning staff men to selected

professional development courses, in addition to staff training courses; and (7) appraisals to check on progress to date.¹

The data suggest that a beginning CPA who holds a Masters Degree plus has satisfactorily completed all of the staff training courses and has a sufficient self study program will be a dynamic professional accountant. Of course, the progressive CPA must continue throughout his professional life to spend a great deal of time, effort, and money in the achievement of a satisfactory body of knowledge.

Local practitioner staff members tend to receive an inadequate training.--Unfortunately, a discouraging sign as far as the development of staff members into progressive accountants is concerned is the fact that the large majority of the local practitioners perform most of their staff training requirements. The most unfortunate aspect of the staff training performed by the local practitioner is that the average local CPA is deficient in such vital knowledge areas as EDP, statistical sampling, and modern quantitative techniques. Thus, the staff training program of the average practitioner does not tend to train the beginning staff accountant in modern skills and techniques.

¹George Webb, "Who Can Complain Now?," The Journal of Accountancy, CXXII (July, 1966), 78-80.

Table 30 indicates that very few local CPA staff members are sent to formal staff training courses sponsored by professional accounting societies. The local CPAs who do not provide the majority of their training did state they do use the American Institute's staff training programs. Thus, the average local practitioners are not concentrating a great degree of their resources into staff training.

Local CPAs usually do not participate in cooperative staff training programs.--A joint training program would be another effective way of supplementing the formal staff training courses. Senior members of local CPA firms could instruct staff members in their special fields of interest. Such a training device would tend to result in an effective supportive training device without creating any undue hardship on the senior members of any particular CPA firm. However, the data suggest that local practitioners, especially the smaller practitioners, seldom combine staffs for the purpose of providing joint staff training programs. The evidence does suggest that local CPAs can achieve many benefits by participating in joint ventures.

The average local CPA staff training program is not designed to provide instruction in modern procedures and techniques.--The data indicate that an adequate training program for a beginning staff member is a continuous process which is complex and varied. Due to the lack of

TABLE 30

AN ANALYSIS OF LOUISIANA LOCAL PRACTITIONER
PARTICIPATION IN STAFF TRAINING PROGRAMS

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Does your firm perform the majority of the staff training?	90	10	89	11	67	23
2. Does your firm cooperate with other local practitioners in joint staff training programs?	5	95	17	83	20	80

emphasis placed on the American Institute's staff training programs, plus the inadequate knowledge level of the average practitioner, it is doubtful if many local CPA staff members receive an adequate staff training course. Furthermore, the evidence indicates that the average local CPA is perpetrating the firm's deficiencies through an inadequate staff training program rather than pursuing an enlightened course of letting beginning staff members obtain the modern skills and techniques needed to successfully compete and provide competent services in this ever changing economy.

Many local CPA firms do use self study aids.--The individual study programs sponsored by the American Institute of Certified Public Accountants made available a means of self study teaching aids. Some of the individual study programs designed by the American Institute of Certified Public Accountants are self teaching devices such as their statistical sampling programs. Moreover, technical studies and other self teaching devices are published in such areas as auditing, financial reporting, management services, practice management, and federal taxation.

The technical studies in the area of management services and federal taxation are methods by which the American Institute of Certified Public Accountants are trying to aid the local practitioners in their professional development. The studies can be used in order to gain a greater degree of proficiency in selected areas and are also useful as

staff training aids. The emphasis of such programs toward the local practitioner is indicated by the title of a recent management services technical study entitled Management Information Systems for the Smaller Business.

Table 31 indicates that a significant segment of the Louisiana local CPA firms have never used either the technical studies in the areas of management services or federal taxation. The use of such studies increases in direct proportion to the size of the CPA firm. Further noted is the fact that the practitioners who have used such technical training aids have generally been satisfied with the overall effectiveness of such self teaching guides.

Many continuing educational programs are designed for aiding the local CPA.--Many other continuing educational programs are sponsored by the American Institute of Certified Public Accountants, state societies of Certified Public Accountants, and other professional accounting societies. The programs are geared to the needs of the local practitioner. Local practitioners, for example, can obtain technical assistance through the American Institute's Technical Information Service which will answer specific questions when requested. Many state CPA societies also provide a CPA Consultation Service which assists local practitioners in solving their problems. Moreover, recently the Management Services magazine announced that leading authorities

TABLE 31

AN ANALYSIS OF THE EFFECTIVENESS OF SELF
STUDY AIDS BY LOUISIANA CPA FIRMS IN
MANAGEMENT ADVISORY SERVICES
AND TAXATION

<u>Types of Experiences</u>	Opinion of Self Study Aids Expressed As A Percentage According To A Professional Staff Of		
	<u>1-5</u>	<u>6-10</u>	<u>over 10</u>
1. Studies are very helpful guides.	21	31	53
2. Studies are fair guides.	21	25	20
3. Studies are not pertinent for use by a local practitioner.	8	6	0
4. Studies have not been used as a self study tool.	50	38	27

would answer questions which are submitted in the management services area.

The relative amount of money which the local CPA spends on professional development activities is meager.--A major cause of the inadequate knowledge level appears to be the failure of the average local practitioner to adopt an adequate professional development program. Many of the large national CPA firms allocate ten per cent of their gross fees to professional development.¹ Unfortunately Table 32 indicates that local practitioners allocate less than two per cent of their gross fees to professional development.

The most recent triennial survey of the revenue and expenses of accounting firms further indicates that very little money is spent on professional development.² A reconstruction of figures from the study indicates that a small CPA firm with a professional staff of five including two partners only spends about \$1,440 annually for their firm's entire professional development program. Included in the \$1,440 figure is \$370 for professional membership expense. Only about \$370 is spent annually by the average small CPA firm with a professional staff of five for

¹Murphy, Advanced Public Accounting Practice, p. 437.

²MAP 14d-Revenue and Expenses of Accounting Firms-Triennial Survey 1967, (New York: American Institute of Certified Public Accountants, Inc., 1967), pp. 11-26.

TABLE 32

AN ANALYSIS OF THE AVERAGE YEARLY TIME AND
MONEY SPENT IN PROFESSIONAL DEVELOPMENT
ACTIVITIES BY LOUISIANA
LOCAL PRACTITIONERS

Yearly Professional Development Activity	Yearly Professional Development Activity Expressed By Days and Percentage Of Gross Fees According To A Professional Staff Of		
	1-5	6-10	over 10
Days per Partner	6	7	8
Days per Staff Man	5	4	7
Percentage of Gross Fees of Firm	1.0	1.4	1.5

professional development courses. Moreover, approximately \$700 is spent for publications.

The average local CPA firm with a professional staff of five spends on professional development courses in the entire year about the amount it takes to send one staff member to a staff training school. Thus, the evidence suggests that the average local practitioner needs to spend a significantly larger amount on professional development courses in order to insure that the members of his accounting firm possess an adequate knowledge level.

The fact is extremely doubtful if the average partner of a local CPA firm attends more than one professional development course per year. The evidence indicates that the overwhelming majority of local practitioners have attended at least one professional development course. However, the average partner has not frequently attended such educational meetings. Even the average attendance of thirteen professional courses by the partners of large local CPA firms is not a significant attendance figure based on the number of years such courses have been available to the average partner. Of course, some practitioners have a very active professional development program. A few local CPAs do attend from five to ten professional development courses every year.

Further noted is the fact that every local practitioner except one who had attended professional development courses expressed the opinion that the courses were helpful

to a local CPA. In fact, a few practitioners stated that the courses were essential.

Professional development activities garner an insignificant amount of the practitioners time.--The data imply that local CPA partners spend from six to eight days on average per year in professional development activities including reading of periodicals in slack time periods. It is extremely doubtful if this length of time spent in professional development courses and self-development activities is adequate for an accountant to maintain his skills at a satisfactory level. The idea has been suggested that twenty to twenty-five per cent of an engineers working hours should be spent in some phase of training.¹ Doubtlessly, professional accountants should spend at least ten per cent of their time in professional development activities in order to surmount the educational gap.

Self development must play a major role in an adequate professional development program.--In view of the ever increasing spread of the knowledge explosion, self development must play a major role in the professional growth of the practitioner. In many areas of accounting, such as taxation, self development is a very effective educational

¹Leon C. Megginson, Personnel: A Behavioral Approach to Administration (Homewood: Richard D. Irwin, Inc., 1967), p. 136.

aid which can be supplemented by formal professional development courses. However, it is extremely questionable if a practitioner can become an expert in computer sciences and quantitative techniques solely on the basis of self study. The evidence suggests that self study should play an important role in the professional development of the CPA, but individual study is generally never a completely satisfactory educational aid when used alone.

Periodicals are excellent sources of self study material.--Periodicals are another excellent medium for the purpose of improving the practitioners knowledge level. Table 33 indicates that the average local practitioner does not regularly read one or more articles in a variety of periodicals geared to the various aspects of a professional accounting practice.

Magazines such as Management Services and Management Accounting which tend to devote the bulk of their material to the management services area rank low on the reading list of the average local CPA. The Harvard Business Review which also is a valuable guide to the area of decision making is seldom read by a local practitioner.

On the other hand, a practitioner more likely than not will regularly read at least one magazine in the taxation area. This regular self study aid doubtlessly helps to maintain the practitioners strong knowledge level in the field of taxation.

TABLE 33

AN ANALYSIS OF THE EXTENT SELECTED PROFESSIONAL
PERIODICALS ARE READ BY LOUISIANA
LOCAL PRACTITIONERS

<u>Periodical</u>	Extent of Reading of Periodicals Expressed As A Percentage According To A Staff Of											
	1-5				6-10				over 10			
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>AL</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>AL</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>AL</u>
1. Harvard Business Review	91	9	0	0	78	11	11	0	53	33	7	7
2. Management Accounting	82	16	2	0	78	17	5	0	53	13	27	7
3. Management Services	58	30	12	0	50	39	11	0	33	27	7	33
4. Taxes-The Tax Magazine	61	16	18	5	39	11	39	11	20	20	46	14
5. Taxation for Accountants	48	25	18	9	56	0	33	11	39	20	14	27
6. The Accounting Review	65	28	7	0	79	11	5	5	27	39	20	14
7. The Journal of Accountancy	7	23	45	25	5	22	56	17	7	14	20	59
8. The Journal of Taxation	58	20	15	7	39	22	28	11	20	14	27	39
9. The Louisiana Certified Public Accountant	2	23	42	32	5	28	39	28	0	14	27	59

Note: N, OC, FR, and AL are abbreviations for Never Read an Article, Occasionally Read an Article, Regularly Read One or More Articles, and Generally Read Almost All Articles, respectively.

The Journal of Accountancy and The Louisiana Certified Public Accountant are the magazines which are read most frequently. The recent decision to have a regular section of technical departments in The Louisiana Certified Public Accountant appears to have been a wise decision. Such sections are excellent methods to expose the local CPA to advanced procedures and techniques which are not usually obtained due to the tendency not to read periodicals in certain fields such as management services.

Review of In-Depth Continuing Educational Courses

In-depth continuing education courses are urgently needed.--The professional development courses offered by the American Institute of Certified Public Accountants are certainly not all inclusive. Major local practitioner educational deficiency areas such as a lack of in-depth EDP knowledge cannot be satisfied in a two day seminar. For example, the Special Committee of the Canadian Institute of Chartered Accountants to Assess the Impact of Electronic Data Processing on the Accounting Professional concluded that at a minimum it would take 20 days or 160 hours of study to master the minimum EDP knowledge requirements.¹ Moreover, this study would include at a minimum three days or twenty-four hours of actual use of the computer. The

¹Gordon H. Cowperthwaite, et al. "Computer Education and the Chartered Accountant-Section 6," Canadian Chartered Accountant, special issue (August, 1967), 45.

detailed subject matter of such an EDP course would include the following:

- computer systems--seven days
- programming languages--three days
- systems design--six days
- audit--three days
- computer applications--one day¹

Thus, the data suggest that there is an immense need in accounting for in-depth continuing educational courses in such areas as EDP, statistical sampling methods, and modern quantitative techniques. Furthermore, the evidence indicates that the universities have an excellent opportunity to participate in in-depth educational programs. The universities at present have almost completely neglected professional development courses in accounting except for the occasional sponsoring of a seminar in taxation.

Universities possess many of the attributes needed for in-depth courses.--The university has many advantages as a center for continuing education. The university can provide training in an efficient manner due to such factors as adequate physical facilities, an abundance of educational training aids, a professional experienced faculty, and a convenient location. Furthermore, universities are a storehouse of knowledge with the availability of professional educators who are specialists in many different areas.

¹Gordon H. Cowperthwaite, et al. "Educational Requirements of the Recommended Body of Knowledge-Section 7," Canadian Chartered Accountant, special issue (August, 1967), 55.

The university also provides an atmosphere for creative thinking and innovative research. Moreover, some universities have had experience conducting in-depth training in areas such as executive development courses.

The universities have the facilities which are required for EDP courses. Most universities have access to computer facilities which are very costly, but an essential factor in EDP training. Moreover, university faculties and local practitioners both tend to have slack schedules in the summer. Thus, the university possesses the facilities, staff, and available time which are needed for an effective EDP training course. Such EDP courses could also serve the purpose of supplementing faculty salaries.

The proposed EDP course would not necessarily have to be given in its entirety in one complete session. The course could be comprised of self study aids along with several meetings of shorter duration.

Various subject areas are suitable for presentation by universities. Modern quantitative techniques, such as statistical sampling methods and operations research techniques, cannot be mastered in a short period of time. For example, statistical sampling courses developed for the use of the Army Audit Agency consist of correspondence courses lasting twelve months supplemented by four separate two-day seminars. Other modern quantitative techniques would also take a longer period of time to master.

The American Institute of Certified Public Accountants, along with the assistance of university personnel, could develop standard outlines of courses which are particularly suitable for presentation by universities. Such courses should be able to be operated at a more reasonable cost plus attracting a larger overall attendance.

A large potential demand exists for university sponsored continuing education courses.--Table 34 indicates that a large potential demand exists for university courses designed to aid the local practitioner. Table 35 suggests that significant demand exists for courses in selected knowledge areas such as taxation, computer service, and systems analysis. The development of integrated case studies would appear to be an ideal vehicle to provide training in the various areas where local CPAs are weak. Several large CPA firms expressed the opinion that they would send one or more staff members to courses in any of the selected knowledge areas.

A few universities have developed accounting professional development courses.--Several universities have developed and presented professional development courses in cooperation with the American Institute of Certified Public Accountants and state professional accounting societies. The Georgia State College developed a two-week intensive

TABLE 34

AN ANALYSIS OF THE LOUISIANA LOCAL PRACTITIONER'S
POTENTIAL DEMAND FOR UNIVERSITY SPONSORED
CONTINUING EDUCATIONAL COURSES

Question	Percentage of Occurrence According To A Professional Staff OF					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Would you be interested in attending a seminar at a Louisiana University with the subject matter geared to the needs of the local practitioner?	93	7	78	22	93	7

TABLE 35

AN ANALYSIS OF THE LOUISIANA LOCAL PRACTITIONER'S
POTENTIAL DEMAND FOR UNIVERSITY SPONSORED
CONTINUING EDUCATIONAL COURSES BY
SELECTED KNOWLEDGE AREAS

<u>Selected Knowledge Area</u>	Local CPA Interest in Courses In Selected Area Of Knowledge Expressed As A Percentage According To A Staff Of					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Taxation of individuals and corporations	60	40	50	50	64	36
2. Taxation of estates	58	42	57	43	58	42
3. Computer languages such as COBOL	38	62	50	50	58	42
4. Auditing the computer	45	55	86	14	79	21
5. Statistical sampling techniques	28	72	22	78	50	50
6. Integrated case studies	23	77	14	86	50	50
7. Systems analysis	48	52	58	42	64	36
8. Accountant's legal responsibility	25	75	36	64	43	57
9. Operations research techniques	25	75	22	78	22	78
10. Other	5	95	0	100	14	86

math course geared for CPAs.¹ The course is composed of twelve hour daily sessions and was equivalent to the knowledge gained in three quarters of college work. This course is presented in cooperation with the American Institute.

The University of Texas presented a highly successful two-day seminar pertaining to the broad area of socio-economic issues emerging in the present day society.² The program was enthusiastically received by the CPAs who attended the course.

The professional accounting societies are beginning to develop a few in-depth professional development courses.--
The accounting professional societies have begun to develop in-depth EDP courses. The Canadian Institute of Chartered Accountants now offers two week-long courses in EDP Concepts and Auditing of EDP systems which use a video-tape format with hands-on computer exercises.³ The American Institute of Certified Public Accountants announced a six-week or 252 hour in-depth professional course on computer data processing. The presentation of such a course depended on a demand of at least twenty practitioners. Forty per cent of the

¹"Intensive Math Course Geared for CPAs," The CPA, XLVII (October, 1967), 5.

²Glenn A. Welsch, Thomas H. Williams, and Charles H. Griffin, "An Adventure in Learning for Certified Public Accountants," The Journal of Accountancy, CXXIII (March, 1967), 83-86.

³"New Video-Tape PD Courses from Canada," The CPA, XLIX (January, 1969), 10.

proposed course will be devoted to writing, debugging, and running about fifteen programs in four different languages with the remainder of the time devoted to punched card processing, analysis and design, hardware and software, and evaluating, selecting, and auditing EDP.¹

The in-depth EDP programs are only reaching an infinitesimal segment of the total practitioner market. Due to the length and cost associated with in-depth courses, the average local CPA will have to spend a significantly larger amount of their time, money, and effort in order to successfully complete any such educational program. Doubtlessly, university preparation in in-depth programs would attract a larger overall audience than the present occasional offerings.

Universities have an excellent opportunity to participate in continuing educational courses.--The data imply that universities can play an important role in the continuing education of accountants. Universities can cooperate with professional accounting societies in the frequent offering of a variety of continuing educational courses in order to provide a greater variety of needed professional development courses in a convenient location at a reasonable cost. Universities can supply other services such as bulletins

¹"CPA Will Offer In-Depth Course on Computer Data Processing If 20 Register by April 25," The CPA, XLIX (April, 1969), 6.

pointing out recent developments in the field, developing self study aids, developing sabbatical educational programs for local CPAs, and acting as consultants to the profession. Such services to the accounting profession would better enable the institutes of higher learning to achieve their objective of providing meaningful educational services to society.

Evaluation of Data

More emphasis on professional development is urgently needed.--The data imply that the knowledge explosion is overwhelming the average local practitioner. One objective of a profession is that beginning members possess a minimum common body of knowledge. The superior weight of the evidence indicates that the accountant must complete at least five years of formal study in order to acquire an adequate beginning common body of knowledge.

A leading university president stated that "In the years ahead we shall witness a veritable revolution in graduate-level education, with at least one graduate degree being required for entrance into an increasing number of professions."¹ The recommendation of the American Institute of Certified Public Accountants that the state CPA societies adopt a five year educational requirement for the CPA examination is a constructive step toward achieving a satisfac-

¹John A. Hunter, "A Look at the Future," Louisiana Schools, XLVI (April, 1969), 4.

tory beginning common body of knowledge on the part of the beginning professional accountants. Of course, due to the speed of the knowledge explosion periodic reviews should be made to reassess the educational requirements necessary to achieve the minimum acceptable knowledge level.

The beginning staff member must also participate in an adequate staff training program in order to build upon his common body of knowledge. However, the data imply that most local CPA staff members are not receiving adequate staff training instruction. The evidence further points out that many local CPAs do not have an adequate professional development program. Thus, the superior weight of the evidence suggests that an important segment of local practitioners are obsolete and are not providing their clients with adequate services.

The evidence suggests that a continuing education requirement would be beneficial to the profession.--The suggestion is made that the accounting profession require all CPAs to adopt a required continuing education program. A dynamic profession cannot afford to have the average practitioner employ methods which are outdated and result in inferior services to their clients. Such a proposed continuing education program could require an accountant to successfully complete a stated number of approved professional development courses in his specific area of interest.

The medical profession has begun to require that members participate in continuing educational courses. The Oregon Medical Association recently became the first state medical society to require its members to pursue a continuing education program. Any physician who does not satisfy the continuing education requirements is placed on probation. Additionally, many secondary and elementary school systems require teachers to take continuing educational courses, plus the fact that remuneration is based partly on the total amount of continuing educational courses taken to date.

The accounting profession should adopt a similar educational requirement. This type of requirement would probably not receive the endorsement of many local practitioners, but a continuing education requirement is a very effective method to insure that the members of the profession possess an acceptable level of knowledge. Presently, despite the availability of professional development courses, many local CPAs do not possess an acceptable common body of knowledge.

Other measures designed to measure competence level would be of value to the profession.--Another possible program would be an objective evaluation of the competency of a local CPA to perform various services. Such a review would be able to point out deficiencies of which an accountant might not be aware.

John L. Carey did propose the idea that CPA firms might be accredited.¹ However, due to the strong opposition to accreditation by local practitioners, the Planning Committee of the American Institute of Certified Public Accountants dropped any further consideration of accreditation. Despite this rejection of accreditation, at least a voluntary review of a local CPA firm would serve a useful purpose in pointing out deficiencies to cooperative local practitioners.

Summary and Conclusions

A brief review of the general evidence pertaining to continuing education.--The data imply that the general knowledge level increases approximately at the yearly rate of ten per cent. Additionally, the overwhelming weight of the evidence indicates that the local practitioner must pursue an active continuing educational program in order to provide their clients with a satisfactory level of services due to the knowledge explosion.

Universities, professional accounting societies, and the individual CPA have important roles to play in the continuing development of the professional accountant. The future success of the local CPA will be determined in a large measure according (1) to the degree to which the local practitioner possesses a satisfactory educational

¹John L. Carey, "Should CPA Firms Be Accredited?," The CPA, LXVII (June, 1967), 3-6.

background; (2) to the availability of adequate professional development courses, plus the degree of participation in such programs; and, (3) to the intensity of the effort, time, and resources employed in self development.

A summary of the data pertaining to continuing education.--An analysis of the data gathered from the Louisiana local practitioner questionnaire strongly suggests that the knowledge explosion, coupled with an inadequate professional development program, have led to the situation where many local practitioners are obsolete in their chosen field of interest. The inferior knowledge level is especially prevalent among the smaller local CPAs.

The factors leading to this educational gap are manifold. The evidence suggests that many beginning CPAs do not possess an adequate common body of knowledge due to the lack of participation in a minimum five year educational program. Moreover, the average local practitioner does not concentrate an adequate amount of time, effort, or money on professional development courses and individual study in order to surmount the educational gap.

The data indicate, for example, that only a few local practitioners are active participants in formal professional development courses with the average local CPA partnership with a professional staff of five only spending yearly on continuing education courses the approximate amount it takes to send one staff member to a staff training

course. Moreover, most beginning local CPA staff members receive their formal training instruction from senior members of the local firm. Unfortunately, the average senior member of a local CPA partnership tends to be deficient in the area of modern procedures and techniques. Additionally, there is a great need and strong demand for a larger variety of continuing educational courses and self training aids.

Conclusions and recommendations concerning the local practitioners professional development program.--The data imply that several constructive steps can be taken in order to insure that the local practitioner performs adequate services for his clients. The American Institute of Certified Public Accountants has taken a very constructive step in suggesting that the beginning accountant complete a five year educational program before beginning his professional accounting career. An adequate five year educational program will better enable the beginning CPA to achieve the present minimum common body of knowledge level.

The suggestion is made that a mandatory continuing educational requirement be an obligation of professional accountants in order to insure that a CPA is competent in his specific field of interest. Such an educational requirement would help the local practitioner to overcome the educational gap plus insuring that a beginning accountant receives a satisfactory training program when the local staff is not able to provide an acceptable level of instruc-

tion. Furthermore, an impartial review of the quality of various services offered by a local practitioner would be a constructive method to upgrade accounting services. A more active participation by universities in providing continuing education courses and self study aids would also be a step in the direction of offering a greater variety of professional development courses including much more emphasis on in-depth techniques and procedures.

The future success of the accounting profession will be determined in a larger degree as to how well prepared the members of the profession are to meet the challenges of the future. Such challenges if successfully surmounted will enable the accounting profession to provide a higher level of useful services to society along with insuring the rapid growth and development of the profession. However, other professions will be prone to supply needed sophisticated services if the average accountant adopts an inferior professional development program which is not designed to overcome the knowledge explosion.

CHAPTER VII

AN ANALYSIS AND EVALUATION OF THE PERTINENT PROBLEM OF INDEPENDENCE AND THE LOCAL PRACTITIONER

Background Information

An independent auditor must be objective.--The purpose of the chapter is to analyze and examine the pertinent problem of independence and how it affects the local practitioner. The investigation will concentrate on those areas where the greatest perceived potentiality for local CPA conflict of interest appears to exist.

A local practitioner who expresses an opinion on the fairness of the financial statements is faced with another major constraint besides competency. The local CPA must also be objective in his judgments and must not subordinate his opinion to the wishes of the client. In fact, the professional accountant must possess the attributes of both competency and independence. The failure to possess either attribute will mar the major function of a professional auditor of expressing an independent opinion on the financial statements.

Independence is an essential auditing attribute due to the fact that the opinion of a professional accountant adds credence to the fairness of financial statements which are the representations of management. The opinion of an accountant who is not independent would add absolutely nothing to the statements, and at the same time, the biased opinion would detract from the information presented in such statements. Thus, in order to assure outsiders that the financial statements are fairly presented, the local CPA must be truly independent in all aspects. The professional accountant must not succumb to the wishes and desires of management, but must exhibit an unbiased outlook. The twin attributes of independence and competency assure the fairness of the accounting data to outsiders along with helping to justify the existence of the accounting profession.

The professional auditor should be truly independent.-

The importance of independence is stressed in the Code of Professional Ethics adopted by the American Institute of Certified Public Accountants. The following excerpt, for example, from the code emphasizes the importance of an auditor's being independent to all objective and informed observers.

Neither a member or associate, nor a firm of which he is a partner, shall express an opinion on financial statements of any enterprise unless he and his firm are in fact independent with respect to such enterprise.

Independence is not susceptible of precise definition, but is an expression of the profes-

sional integrity of the individual. A member or associate, before expressing his opinion on financial statements, has the responsibility of assessing his relationships with an enterprise to determine whether, in the circumstances, he might expect his opinion to be considered independent, objective and unbiased by one who had knowledge of all the facts.¹

Various ethical rules govern the activities of professional accountants.--The American Institute of Certified Public Accountants has established other guidelines in order to help insure that the professional accountant does remain independent. The independent auditor, for example, is not considered independent if during the audit engagement and/or at the time of expressing an opinion on the financial statements the CPA had or was committed to acquire any direct financial interest or material indirect financial interest in the enterprise. Moreover, during this same time period of performing the engagement and/or expressing an opinion, the accountant is not considered independent if he is associated with the client as a promoter, underwriter, voting trustee, director, officer, or key employee. Additionally, other ethical rules prohibit the independent auditor from engaging in the following activities: (1) making managerial decisions for the client, (2) engaging in a business or occupation which is incompatible or inconsistent with a professional accounting practice, (3) engag-

¹Code of Professional Ethics and By-Laws, p. 6.

ing in the payment of contingent fees except in specified cases and, (4) engaging in the practice of sharing forwarding fees with the laity.

Professional and auditing independence are two aspects of accounting independence.--John L. Carey states that there are two distinct aspects associated with professional accounting independence. Mr. Carey points out that one aspect called professional independence is important to all professions when he states "Independence, in the sense of being self-reliant, not subordinate, is essential to the practice of all professions."¹ Moreover, Mr. Carey further states in the following that another aspect which may be called auditing independence has a special meaning to the Certified Public Accountant:

It is most important that the CPA not only shall refuse to subordinate his judgment to that of others but that he be independent of any self interest which might warp his judgment even subconsciously in reporting whether or not the financial position and net income are fairly presented. Independence in this context means objectivity or lack of bias in forming delicate judgments.²

Professional independence is an essential attribute of any profession. The professional auditor must be self-reliant and must not subordinate his professional judgment to the wishes of his client or outsiders.

¹Carey, Professional Ethics of Certified Public Accountants, p. 20.

²Ibid., p. 21.

The auditing phase of independence is peculiar to the accounting professional. In order to obtain auditing independence, the auditor must avoid "situations which would tend to impair objectivity or permit personal bias to influence delicate judgment."¹ Thus, the professional auditor must avoid situations which could possibly bias his judgment either consciously or subconsciously. The auditor must be free from any undue influence which might sway his judgment resulting in the rendering of a less than objective opinion.

The professional accountant must be independent both in fact and in appearance.--A professional accountant must be truly independent. The accounting profession has recognized the idea that accountants must not only be independent in fact, but must also give an outward appearance of being truly independent. Mr. Carman Blough was one of the first leading accounting authorities to recognize this independence duality when he stated that:

Since one's usefulness as an auditor is impaired by any feeling on the part of third parties that he is likely to lack independence, he has the responsibility of not only maintaining independence in fact but of avoiding any appearance of lacking independence.²

¹John L. Carey and William O. Doherty, "The Concept of Independence--Review and Restatement," The Journal of Accountancy, CXXI (January, 1966), 38.

²Carman G. Blough, "Responsibility to Third Parties," The Journal of Accountancy, CIX (May, 1960), 60.

A former chairman of the American Institute of Certified Public Accountant's Committee on Professional Ethics expressed a similar opinion of the independence duality in the following:

There are two kinds of independence which a CPA must have...independence in fact and independence in appearance. The former refers to a CPA's objectivity, to the quality of not being influenced by regard to personal advantage. The latter means his freedom from potential conflicts of interest which might tend to shake public confidence in his independence in fact.¹

Areas of Possible Conflict of Interest

The peculiar nature of both the local practitioner's operation and type of client may lead to the situation where conflict of interest is a possibility.--Due to the fact that unique services are associated with local practitioners, the local CPA appears to be more highly susceptible to a possible conflict of interest in certain areas as contrasted to the national and regional CPA firms. One possible area of conflict is the rendering of both management advisory services and independent auditing services to the same small client.

The data indicate that the average small businessman is not proficient in all of the functions of management. Many times the businessman who seeks management advisory service is forced to almost completely rely upon the local

¹Thomas G. Higgins, "Professional Ethics: A Time for Reappraisal," The Journal of Accountancy, CXIII (March, 1962), 31.

practitioner to make the decisions, particularly in situations pertaining to areas where the client does not possess the necessary expertise to make an informed decision.

The local CPA who renders management advisory services to small clients is in an extremely vulnerable situation of participating in the decision making function and/or developing a close relationship with the client. The process of making decisions is practically forced upon the local practitioner in those cases where the client is almost completely incompetent...particularly in those areas where specialized management advisory services are performed.

Moreover, the professional local auditor generally does participate in some phase of the decision making process. Due to the general practice of local CPA's not rotating partners and not having separate auditing and management services staffs, the potential of the local practitioner's developing such a close relationship with the client so as to empathize with management does exist. Such a close relationship would be undesirable due to the possibility of either consciously or subconsciously losing objectivity.

On the other hand, the large corporations which are usually served by a large national CPA firm will have a sufficiently large internal staff which possesses the ability to review and assess the management services work. Moreover, the management services work is generally performed by a separate staff as contrasted to the auditing staff.

Some accounting authorities express the opinion that the rendering of management advisory services and auditing services to the same client is compatible.---The Ethics Committee of the American Institute of Certified Public Accountants is of the opinion that no conflict of interest exists in the rendering of both independent auditing services and management advisory services to the same client as long as the services are limited to advice and technical assistance. However, the opinion does state that the making of management decisions would impair the auditors independence as is indicated in the following summary of this opinion:

In summary, it is the opinion of the committee that there is no ethical reason why a member or associate may not properly perform professional services for clients in the areas of tax practice or management advisory services, and at the same time serve the same client as independent auditor, so long as he does not make management decisions or take positions which might impair that objectivity.¹

The argument has been made that advising and decision making are separable. Some leaders in the accounting profession agree with the American Institute of Certified Public Accountants' Committee on the Code of Professional Ethics that there is a fine dividing line between advising and decision making. The decision process has been broken down into the following steps:

¹Code of Professional Ethics and By-Laws, p. 26.

1. Determining the nature of the decisions which could possibly be taken, i.e., delineating the possible acts.
2. Determining the set of events which could occur, and one of which must occur, which have an effect on the outcome of the operation.
3. Determining the expected profit or loss from each act-event combination.
4. Determining the probability of occurrence of each event.
5. Computing the expected value of each act and selecting the act with the highest expected value.¹

One author contends that independence will be maintained if advice is confined to the first three steps shown above.² Additionally, other authors contend that it is doubtful whether even the fourth step would suggest a conflict of interest to a reasonable observer.³

Some accountants suggest that advising and decision making are inseparable.--Other leading accounting authorities suggest that advising and decision making cannot be separated. Mautz and Sharaf expressed this opinion when they stated:

¹Carey and Doherty, Ethical Standards of the Accounting Profession, p. 24.

²Kenneth S. Axelson, "Are Consulting and Auditing Compatible?," The Journal of Accountancy, CXIV (April, 1963), 54.

³Carey and Doherty, "The Concepts of Independence--Review and Restatement," p. 41.

Management, of course, is at liberty to accept, modify, or reject a given piece of expert advice. But advice is requested on the premise that it will be given rational consideration. It is requested because management feels its own inability to know all the alternative solutions to the problem at issue and to evaluate them and choose from among them. Management wants the advice and intends to use it; advice is sought and paid for to be followed, not to be ignored. It seems folly indeed to separate advising and judgment making. This is true whether the advice is concerned with income tax, systems, or general business decisions.¹

Outsiders appear to be of the opinion that providing both management services and auditing services may lead to a conflict of interest.--Regardless of whether or not one accepts the proposition that there is a fine dividing line between advising and decision making, there is always the possibility of lack of independence in the eyes of outsiders. One survey of financial institutions found that approximately one third of the respondents seriously doubted whether a CPA was able to maintain an independent outlook when he rendered both management services and independent auditing services to the same client.²

The findings of the above study have been questioned due to the failure of the research investigation to define

¹R. K. Mautz and Hussein A. Sharaf, The Philosophy of Auditing (Menosha: American Accounting Association, 1961), p. 221.

²Arthur A. Schulte, Jr., "Compatibility of Management Consulting and Auditing," The Accounting Review, XL (July, 1965), 587-593.

management consulting. However, a similar study which was designed to eliminate the deficiencies in the above cited investigation was performed. The new study confirmed the previously mentioned conclusions as the data suggest that about fifty per cent of the financial community believe the rendering of management services in conjunction with the independent auditing services is incompatible with an auditor's independence.¹

The evidence does suggest that a significant segment of the influential financial community question the propriety of an auditor's providing both management advisory services and independent audit services. Some accountants who believe there is no basic incompatibility between consulting and objective audit independence do express the opinion that "the consulting relationship is potentially dangerous for maintenance of subjective audit independence."²

All types of management services do not appear to possess the same probability of resulting in a conflict of interest.--Questionable is the fact that all the types of management services rendered possess the same potentiality of affecting independence either in fact or appearance.

¹Abraham J. Briloff, "Old Myths and New Realities in Accountancy," The Accounting Review, XLI (July, 1966), 491.

²D. R. Carmichael and R. J. Swieringa, "The Compatibility of Auditing Independence and Management Services--An Identification of Issues," The Accounting Review, XLIII (October, 1968), 705.

Accountants have been rendering services in the general area of the client's information system for many years in such diversified activities as inventory control, budgeting, and costing methods apparently without resulting in any great degree of conflict of interest. Manuel F. Cohen stated while serving in the capacity as Chairman of the Securities and Exchange Commission that the logically related consulting services in the broad general areas related to the financial process or to the information and control system "do not appear to pose a serious threat to the accountant's independent status."¹

Mr. Cohen further suggests that management advisory services not related to the above mentioned broad general areas raise doubts as to possibility of conflict of interest. Moreover, the Ethics Committee of the American Institute of Certified Public Accountants is of the opinion that CPAs should carefully consider whether they ought to render services in certain peripheral areas of management services like market surveys.² Of course, services in peripheral areas of management services are generally more often performed by the larger CPA firms.

¹Manuel F. Cohen, "The SEC and Accountants: Co-Operative Efforts to Improve Financial Reporting," The Journal of Accountancy, CXXII (December, 1966), 57.

²"Reports Were Made to Council on Independence," The CPA, XLI (June, 1969), 8.

Separate management services and auditing staffs
help to reduce the possibility of conflict of interest.--
The evidence does strongly suggest that the local practitioner is particularly susceptible to being less than objective when offering a combination of management and auditing services to the same client. Such a conflict of interest is much less likely to develop in a large national CPA firm due to such factors as larger client internal staffs, more depth and breadth in management, and separation of independent accounting staffs. However, the larger national CPA firms do not appear to be completely immune to situations where a conflict of interest is possible. A senior partner of a large accounting firm recently stated that some accounting firms "say they draw the line against consulting that involves them in management decision-making. But don't let anybody fool you. We take on any job."¹

An effective means of avoiding a potential conflict of interest is to recognize specialists in the fields of auditing, taxation, and management services. The separation of staffs, for example, into auditing and management advisory services would be a constructive method in order to avoid suspicion of lack of objectivity. Additionally, the separation of partners into areas of interest would further make the probability of conflict of interest extremely remote.

¹"Accountants Turn Tougher," Business Week, October, 18, 1969, p. 124.

The data in Table 36 infer that the complete separation of auditing and management advisory services personnel is almost never achieved among the smaller local practitioners due no doubt to the small staffs such as only one partner would be included on the staff of a sole practitioner. The data further indicate that even the majority of the medium and large sized practitioners at least frequently use some duplicate personnel in the performance of management advisory services and auditing work for the same client.

A more detailed analysis and evaluation of the data imply that a direct and positive correlation exists between separate management services departments and the use of completely separate auditing and management advisory service personnel. All of the local practitioners with a separate management advisory department either never use the same personnel or only occasionally use identical personnel when performing both management advisory services and independent auditing services.

The use of a separate management service department not only tends to increase the probability of providing a higher level of management advisory service, but also of taking a major step in the direction of overcoming the appearance of any conflict of interest. Of course, the practicality of establishing a separate management advisory service department is limited to the larger local practitioners.

TABLE 36

AN ANALYSIS OF THE FREQUENCY OF USE OF DIFFERENT
SUPERVISORY PARTNERS WHEN MANAGEMENT ADVISORY
SERVICES AND INDEPENDENT AUDITING SERVICES
ARE BOTH PROVIDED FOR THE SAME CLIENT

<u>Question</u>	Percentage Of Use According To A Professional Staff Of											
	1-5				6-10				over 10			
	<u>AL</u>	<u>FR</u>	<u>OC</u>	<u>N</u>	<u>AL</u>	<u>FR</u>	<u>OC</u>	<u>N</u>	<u>AL</u>	<u>FR</u>	<u>OC</u>	<u>N</u>
1. If you perform both management services work and render an opinion on financial statements for the same client, is the same partner in charge of both services?	82	9	9	0	31	44	19	6	22	42	14	22

Note: AL, FR, OC, and N are abbreviations for Always, Frequently, Occasionally, and Never, respectively.

The financial community tends to believe there is greater probability of conflict of interest among local practitioners.--The greater potentiality for conflict of interest among the local practitioners is quite apparent among the financial community according to a recent study in this area. The study found that the members of the financial community expressed the following opinion pertaining to independence and the local practitioner:

Several respondents, especially from the largest financial institutions, and more particularly from the largest banks, believe that the size of the CPA firm is a crucial factor in judging the compatibility of management services and audit independence. The general theme of their thinking is that management consulting has less impact on the CPA's independence where management and auditing services are rendered by separate staffs.¹

The local practitioner may become an employee of the small business.--Another potential conflict of interest area especially pertaining to the small business is that the local CPA may in effect become an employee of the small firm. The suggestion has been made that management of small firms often engage a local CPA or other consultant to act in the capacity of the controller and his staff of specialists due to the fact that it is not economically feasible to hire such employees on a full time basis.² The evidence gleaned

¹Arthur A. Schulte, Jr., "Management Services: A Challenge to Audit Independence?," The Accounting Review, XLI (October, 1966), 727.

²R. E. Witschey, "The Accounting Function for Small Business," The Journal of Accountancy, CVII (December, 1958), 37-39.

from the small business studies sponsored by the Small Business Administration indicate that the average small business needs the aid of such a part time consultant.

The part time controller in such a situation raises serious doubts as to the independence of such a consultant. It is entirely possible that a mutuality of interest could develop between the local practitioner and the small businessman.

The local practitioner is in an extremely difficult situation when striving to provide the most useful services to his small business client. On the one hand, the small businessman needs the type of management advisory services which in effect provide the small firm with the equivalent services which are provided to the large corporation by the comptroller and his staff of specialists. Such services either involve directly making management decisions or certainly participating in some phase of the decision making process. On the other hand, the smaller local CPAs do not possess a large enough staff in order to have separate auditing and management advisory services personnel. Moreover, the individual practitioner has no opportunity whatsoever to have separate partners supervise the auditing and management advisory service activities.

National CPA firms do have specialized staffs to perform services in situations where possible conflict of interest may exist.--Table 37 indicates that a few national

TABLE 37

AN ANALYSIS OF THE OCCURRENCE OF A NATIONAL
CPA FIRM LOCATED IN LOUISIANA ACTING IN
THE ROLE AS A CONTROLLER
FOR A SMALL BUSINESS

<u>Question</u>	<u>Percentage Of Occurrence</u>	
	<u>Yes</u>	<u>No</u>
1. Does your firm ever act in the capacity of a controller for a small firm?	33	67

CPA firms with offices located in Louisiana serve small businesses in the role which is equivalent to the services provided by the controller and his staff of specialists. More importantly the national CPA firms have separate staffs to perform both the services of the controller and the work of independent auditor.

Additionally, the Table 38 indicates the same partner is never in charge of both the staffs which perform the independent auditing services and management services of acting as a controller and his staff of specialists. Doubtlessly, the separation of staffs and partners is for the purpose of helping to avoid the appearance of lack of objectivity and providing for the use of specialized skills. Additionally, one national CPA firm stated that when they act as a controller for a small firm, they will not render an opinion on the financial statements due to the problem of independence. It is probably not practical nor feasible to expect the CPA's firms ever to agree on a large scale not to perform auditing and management advisory services for the

TABLE 38

AN INVESTIGATION TO DETERMINE IF THE NATIONAL CPA
FIRMS LOCATED IN LOUISIANA WHO ACT AS A
CONTROLLER PLUS PROVIDE AUDITING
SERVICES FOR THE SAME SMALL
CLIENT HAVE SEPARATE
PARTNERS IN CHARGE
OF EACH ASSIGNMENT

<u>Question</u>	<u>Percentage Of Occurrence</u>	
	<u>Yes</u>	<u>No</u>
1. If you do act in the capacity of a controller for a small firm and also render an opinion on the firm's financial statements, will the same partner be in charge of both assignments?	0	100

same client. However, the CPA firm has an obligation to take all possible action necessary to insure that the potential question of conflict of interest is extremely remote. Unquestionably, the process of separating staffs and partners in charge of various services is a constructive step in the direction of helping to solve the problem of independence in fact and especially in appearance.

The performance of bookkeeping services may be an area where there will be a possible future conflict of interest.--Another potential problem area of conflict of interest for a local practitioner is when the independent auditor also acts as a bookkeeper. The Securities and Exchange Commission is of the opinion that the auditor's independence is questionable when the registrant's books are also kept by the CPA. However, in general, the American Institute of

Certified Public Accountants does not believe that the auditor's independence is impaired when he also writes up his client's accounting records. Nevertheless, the American Institute of Certified Public Accountants does suggest that the auditor would be in conflict of interest if he did perform management functions along with the rendering of an opinion on the representations of the client's financial statements.

The American Institute of Certified Public Accountants periodically reviews the propriety of its opinion pertaining to bookkeeping, but the decision has not been altered. However, if the Code of Professional Ethics rule on rendering auditing and bookkeeping services is ever changed, the large segment of local practitioners who are heavily engaged in bookkeeping services would be adversely affected. In view of generally low profitability of bookkeeping services and the availability of efficient means of processing routine accounting data, the smaller practitioners who rely on bookkeeping services for the bulk of their fees should seriously consider upgrading their services.

Rendering of management advisory services to two or more clients whose interest conflicts raises ethical problems.--Another possible area where conflict of interest could occur is in the process of rendering services to two or more clients whose interest may conflict. In all likelihood the situation may arise more frequently in the render-

ing of management advisory services. Moreover, the probability of such a conflict of interest arising will multiply with the increase in the frequency of providing such services in the future. The evidence in Table 39 infers that most of the medium and larger local practitioners will render management services to competing clients in similar decision making areas such as a review of pricing policies. A slight majority of the smaller local practitioners stated they would not render such services. Furthermore, one practitioner stated that he was never called upon to render such services and does not know whether or not he would render such services if they were requested. The American Institute of Certified Public Accountants approves of rendering services to clients where conflict of interest is present provided full disclosure is made to the concerned parties.¹

An audit committee is an effective method of reviewing accounting services for the probability of conflict of interest.--A means is available for a company to evaluate the probability of possible conflict of interest on the part of the CPA. The use of an audit committee composed of outside directors is an effective way to judge the work of the independent professional accountant. Such an audit committee would be an excellent method for local practitioners to indicate their relationships to other clients in the area

¹Carey and Doherty, "The Concept of Independence-Review and Restatement," p. 47.

TABLE 39

AN ANALYSIS OF THE DEGREE OF FREQUENCY TO
WHICH LOUISIANA LOCAL PRACTITIONERS
RENDER MANAGEMENT ADVISORY SERVICES
TO COMPETING CLIENTS IN SIMILAR
DECISION MAKING AREAS

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Would your firm render management services to competing clients in similar decision making areas such as a review of pricing policies?	47	53	82	18	72	28

of rendering services to clients whose interests may conflict. The audit committee would be a very fine means for clients to analyze and evaluate the potentiality for true conflict of interest.

The ad hoc committee on independence of the American Institute of Certified Public Accountants expresses the following opinion pertaining to the use of audit committees:

Accordingly we are presently of the opinion that if a CPA is going to render a management service which appears to involve a material business decision--say, in the acquisition of another company or a substantial expansion (or contraction) of product lines--he should first be required to get approval of his engagement, and the scope thereof, from the company's audit committee.

.

We also think it might be desirable for the CPAs to report periodically to the audit committee concerning all services rendered so that all the cards are on the table.¹

Local practitioners should encourage their clients to establish an audit committee.--The audit committee helps to protect the practitioners and client by reducing the probability of conflict of interest by rejecting services where such a conflict of interest is perceived to be probable. Moreover, an audit committee is an effective means of bridging the appearance of independence gap by the means of serving the role of an independent review board which would probably recognize a potential service which might appear to be a conflict of interest.

¹Malcolm M. Devore, "Compatibility of Auditing and Management Services--III. A Viewpoint From Within the Profession," The Journal of Accountancy, CXXIV (December, 1967), 39.

The data in Table 40 infer that the overwhelming majority of small businesses have not set up an audit committee to appoint the independent auditors and review the local practitioners actual and proposed services. The audit committee is almost exclusively associated with the clients of the larger local CPA firms. However, only about thirteen per cent of the large local CPA firms have clients which have established an audit committee.

A further analysis of the data indicates that the use of the audit committee by clients of large CPA firms is limited to those firms with a separate management services department. In all likelihood, the establishment of an active and progressive management advisory service department will encourage the growth and use of audit committees.

Due to the general lack of a separate management advisory service staff and the higher probability of a conflict of interest among local CPAs in certain areas, it would appear that local practitioners should be strong proponents for the establishment of audit committees. Additionally, the executive committee of the American Institute of Certified Public Accountants recommends "that publicly owned corporations appoint committees composed of outside directors (those who are not officers or employees) to nom-

TABLE 40

AN ANALYSIS OF THE FREQUENCY AT WHICH THE
LOCAL PRACTITIONER'S CLIENTS HAVE
ESTABLISHED AUDIT COMMITTEES

<u>Question</u>	Percentage Of Occurrence According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do any of your clients have an "audit committee" to re- view your management services work?	3	97	0	100	13	87

inate the independent auditors of the corporations' financial statements and to discuss the auditors' work with them."¹

Evaluation of Data

Many interrelating factors appear to suggest that a small CPA is not able to offer a comprehensive line of accounting services.--The data developed in this study infer that the sole practitioner and to a lesser extent the smaller local firm are being extremely affected by such factors as the ever broadening scope of accounting services, the ever increasing knowledge explosion, and the use of sophisticated EDP equipment to gather information. These interrelating factors strongly suggest that the small local firm or sole practitioner is not able to offer in a competent manner a comprehensive line of services.

The data developed in this chapter indicate that it is not always feasible for a local practitioner to provide all of the accounting services required by a small business even when one assumes the local CPA is competent due to the possibility of a conflict of interest. The local practitioner, for example, would violate the Code of Professional Ethics if he served in a capacity of a controller who helped to formulate and, also, to make management decisions plus

¹"AICPA Executive Committee Statement on Audit Committees of Boards of Directors," The Journal of Accountancy, CXXIV (September, 1967), 10.

performing the independent auditing services for the same client. However, many small businesses actually need the services of such an outside decision maker in order to operate in an economical manner.

The available evidence suggests that the smaller local CPA should restrict his services to a narrower range in order to perform his services in a professional manner.--

The overwhelming weight of the evidence implies that the various aspects of the knowledge explosion and to a lesser extent the Code of Professional Ethics limit the type of services which can be competently performed by the local practitioner. Moreover, the data infer that it is almost physically and mentally impossible for the sole practitioner and to a lesser degree the smaller local firm to offer a complete and adequate comprehensive level of services to their clients.

An analysis of the data does suggest that the sole practitioner and the smaller CPA firm will have to specialize in order to offer an adequate quality of services. Moreover, every practitioner included in this sample, except one, offers a broad range of services despite the fact an analysis of the available data infers that the average practitioner, especially the smaller CPAs, are not competent enough to offer such a broad range of services. Thus, in many cases the small businessman does not receive adequate professional services or the needed services are not

provided due to a lack of adequate knowledge to perform the services in a competent manner.

The suggestion is made that if specialists were recognized the smaller local practitioner would be in a position to offer a much higher level of competent services since his services would be restricted to a narrower field of interest. Furthermore, the recognition of specialists among sole practitioners and smaller local firms would tend to establish a relationship where one practitioner would provide specialized management advisory services and another practitioner would provide independent auditing services with the result that such services are provided without the potentiality of conflict of interest existing.

The practitioners could operate in association with other local CPAs in an arrangement similar to a clinic operated by medical doctors. Such an arrangement of local practitioners by field of interest would enable the association of local practitioners to provide the small business with a solid variety of competent services without the existence of the possibility of a conflict of interest.

Summary and Conclusions

A local practitioner is more likely than a national CPA firm to be confronted with a conflict of interest situation.--The evidence implies the local practitioner is more susceptible than a national CPA firm to face certain situations which might at least lead to the appearance of a con-

flict of interest. The average small businessman's lack of expertise in certain areas of management can possibly lead to the situation where the local CPA actually makes management decisions and/or develops a close relationship with the small client which may result in a loss of objectivity.

Additionally, the small business' demand for expert advice may result in the situation where the practitioner who provides auditing services will also furnish the services which are equivalent to those provided to a large corporation by the controller and his staff of specialists. The furnishing of the services of a controller could result in the local CPA's becoming in effect an employee who directly makes management decisions.

Another selected area which might result in a conflict of interest is when management advisory services are provided to competing clients without their knowledge. Such services may have a material effect on the present and future operations of competing clients despite the fact that management is unaware of the dual role of the CPA.

Moreover, the use of nearly identical professional accounting staffs to perform both management advisory services and independent auditing services may well lead to a state which results in a lack of independence at least in appearance. Many of the members of the financial community, for example, express the opinion that conflict of interest is more likely to occur among local practitioners.

Local practitioners can take several constructive steps in order to lessen the potentiality of a conflict of interest and to provide a higher quality of services to their clients.--The local practitioners and their clients can take several steps which the evidence suggests are significant means of helping to overcome the possibility of a conflict of interest. The local CPA firms can establish separate management advisory service departments. The establishment of a separate management advisory service department would allow the practitioner to use separate staffs in the process of providing both management advisory services and independent auditing services to the same client. The use of separate staffs does appear to significantly lessen the appearance of conflict of interest as the independent auditor is certainly not as prone to participate in decision making processes and is less likely to develop a close association with management.

The data imply that the establishment of audit committees by small business would be an effective means of helping to guard against a situation where a conflict of interest is probable. Thus, the audit committee is a tool which local practitioner's clients can use to help guard against intentional or unintentional lack of objectivity on the part of the local CPA.

The data suggest that few steps are presently being taken to lessen the potentiality of local practitioner conflict of interest. The overwhelming majority of the Louis-

iana local practitioners do not have any clients which have an audit committee despite the fact that most of the local CPAs will provide services to competing clients in areas affecting the decision making process.

Additionally, the evidence indicates that few practitioners use separate auditing and management advisory staffs despite the fact that the rendering of a combination of such services to a small business may appear to lead to a conflict of interest. Of course, the larger local CPA firms are more likely to employ separate professional staffs due to the occurrence of larger staff sizes which generally results in the overall possession of a greater variety of specialized talents.

A relatively small but growing trend is making its appearance among the larger local CPA firms in Louisiana to cope with the twin problems of knowledge and independence by establishing separate management services departments. Such steps along with the establishment of audit committees by their clients should enable the larger local CPA firms to better satisfy the professional accounting needs of the small businessman without the appearance and/or actual lack of objectivity.

Furthermore, the evidence indicates the smaller local CPAs and to a lesser extent the larger CPA firms are not able to offer in a competent manner a comprehensive variety of services due to such factors as an always increasing learning curve which does not ever reach a level

plateau and the lack of an adequate staff size to provide specialized services. The evidence does strongly suggest that the smaller practitioner could better serve the needs of their clients by specializing in a narrower field of interest. Such specialized services would appear to result in the providing of a higher quality of services to the small businessman.

CHAPTER VIII

SUMMARY AND CONCLUSIONS

A review of the accounting problems and needs of the typical small business.--The principal objective of the study is to analyze and evaluate the use of accounting data in small businesses; to determine what accounting services are needed by the average small firm; to determine what services the local practitioners are actually providing local entrepreneurs; to analyze and evaluate the overall effect of the knowledge explosion, attest function, widening scope of accounting services, referral system, and professional ethics on the type of quality of services offered by local CPA's; and to propose various methods which might be taken to improve the quality and types of services offered by local practitioners in order to enable their small clients to operate in a more efficient, economical, and effective manner.

The evidence indicates that many small businesses do not have a long life as only about one out of five new businesses survive for a period of ten years, plus the fact past success does not guarantee future prosperity as businesses ten years or older comprise each year a significant segment

of small business failures. Moreover, the data pertaining to the analysis of business failures indicate that the majority of such failures are due to a complex variety of interrelating factors which result in the breakdown in the internal information system resulting in the making of uninformed management decisions.

Additionally, studies of small enterprises sponsored by the Small Business Administration indicate that the typical small firm is not operated in an efficient manner. The small business studies suggest that the major factor leading to ineffective operations is the making of uninformed management decisions which is generally caused by the failure of the internal information system to provide material, timely, relevant, and accurate data and/or management does not utilize data in the decision making process.

The evidence further suggests that small firms which engage in thorough strategic planning plus formulate management decisions with the aid of an adequate internal information system will in all likelihood operate in an efficient manner. Moreover, the same studies have demonstrated that a direct and positive correlation exists between the use of accounting data and a successful operation including the use of such simple tools as ratio analysis.

Additionally, studies of small business operations indicate the typical accounting system of a small business is mainly oriented toward furnishing external reports and to a lesser extent providing financial control. In the cases

where the internal information system provides meaningful data, many times management lacks the basic accounting knowledge which is required to utilize effectively the data in the manner in which it is presented.

The fact is that the manager of a small firm typically makes the operating decisions, but generally lacks the necessary expertise to make optimum operating decisions pertaining to all the various aspects of his business. Small business studies indicate that small firms urgently need the part time assistance of competent outside advisors to conduct a thorough analysis and review of the firm's total situation with continuing help in the areas where the firm's personnel do not possess the necessary expertise to make optimum decisions. Moreover, the small business studies point out that local practitioners who continue to offer an acceptable quality of service aided by a continuing, adequate professional development program make very effective and economical counselors.

In summary, the overwhelming weight of the evidence implies that an efficiently operated business regardless of its size must possess an adequate internal information system. However, the typical small business is not being operated in an optimum manner resulting in the inefficient use of human and nonhuman resources. The major problem area facing the average small business appears to be the failure of the internal information system to provide accurate, material, relevant, and timely data in a useable form for

use in formulating management decisions. Moreover, the local practitioner can serve a very useful service by designing more pertinent and adequate internal information systems, plus providing expert advice in the areas where management does not possess the necessary expertise.

A review of accounting services currently provided by Louisiana local practitioners.--The data gleaned from the questionnaires completed by Louisiana local practitioners indicate that the average present day local CPA does not concentrate his services in any one specialized area. Additionally, the data infer that there is a wide disparity of types and quality of services provided by local CPA's. Furthermore, the superior weight of the evidence implies that many local practitioners are not currently providing in certain areas a minimum acceptable quality level of services; nor is the small business generally being supplied with the optimum type of services of which it is in such need.

In general, the typical local CPA is rapidly phasing out write-up work and increasing the percentage of services performed in the areas of auditing and management services while tax work is on a fairly level plateau. However, it is noted that about one out of five local practitioners still perform more than forty per cent of his services in the write-up area.

Auditing services range from only providing an opinion on the representations in the financial statements to additionally providing some form of ratio analysis to also furnishing a management letter. Approximately ten per cent of the local CPAs do not provide any additional auditing services beyond the short-form report while most practitioners do compute and compare financial ratios.

However, the evidence infers that the typical local practitioner does not provide his small business client with the optimum type of services needed by a small firm. The evidence indicates that over sixty per cent of the smaller and medium sized local practitioners do not frequently provide their audit clients with a management letter pertaining to the internal information system for planning, control, and decision making despite the fact that small business studies indicate that small firm's greatest need is for such an evaluation.

A variety of management services are performed by the local practitioner but generally not on a systematic, organized basis. The more traditional management services are frequently performed while EDP and the more modern management accounting techniques are being performed only occasionally. However, the local small businessman cannot expect to correct his major accounting deficiency of failing to use in the decision making process data gathered from an adequate internal information system as long as the local CPA fails to provide services in this area due to the

practitioners lack of a sophisticated knowledge of such techniques.

The local practitioner appears to be most proficient in the area of individual and corporate taxation. Services are provided less frequently in the more complex area of estate taxation.

An analysis of the problems confronting the local practitioner.--The evidence indicates that the major stumbling block which prevents the local practitioner from performing the needed services to his small business clients is due to the knowledge explosion. The knowledge required to perform a high quality of accounting services is expanding at an ever increasing rate and never reaches a level plateau. The data indicates that the knowledge explosion has overwhelmed the average local practitioner, particularly in such areas as EDP, modern managerial accounting techniques, and statistical sampling methods.

The evidence suggests that the average Louisiana local practitioner has an EDP knowledge level which is significantly below the minimum standards recommended by a special EDP committee sponsored by the Canadian Institute of Chartered Accountants for the purpose of either auditing a client who uses a computer or for rendering management services in the EDP area. The weak EDP knowledge is extremely significant due to the fact that over eighty-five per cent of the local CPA's have at least some clients who used the

facilities of a computer in processing and analyzing their data. Moreover, the weak EDP knowledge level leads to the situation where the average local practitioner is unable to analyze and design the optimum use of EDP facilities for their small client.

The failure of the average small businessman to use accounting data in the decision making process is doubtless-ly due partially to the failure of the local CPA to possess a good working knowledge of modern accounting techniques such as the failure of over sixty per cent of the local practitioners to have a good working knowledge of direct costing techniques. The weak knowledge of modern management accounting techniques will tend to result in the less progressive practitioners' overlooking the value of an accounting system designed to supply relevant data for internal management use. However, many local practitioners are beginning to perform occasionally some services in the managerial accounting area.

The educational gap is caused by several interrelated factors. The general knowledge level increases approximately at the yearly rate of ten per cent, and the practitioner who wishes to provide his client with an excellent quality of services must (1) possess a satisfactory educational background; (2) participate actively in a well conceived professional development program; (3) concentrate individual efforts in a particular area of accounting; and (4) employ an adequate amount of effort, time, and resources

in self development. However, the data indicate that the average local practitioner is deficient in all of the four areas listed above. The local CPA usually does not acquire the minimum beginning common body of knowledge due to the lack of participation in a minimum five year educational program. Furthermore, few local practitioners are active participants in formal or informal professional development courses as the average local CPA partnership with a professional staff of five spends yearly on continuing educational courses the approximate amount taken to send one staff member to a staff training course. Additionally, the average partner of a local CPA firm only spends about four per cent of his time in some form of continuing educational activities despite the fact that accounting knowledge is increasing at a swift pace. Moreover, the local CPA who tends to be deficient in modern accounting techniques and procedures usually perpetuates the deficiency by training their staff members rather than sending them to staff training schools sponsored by the American Institute of Certified Public Accountants.

The knowledge explosion and the widening scope of accounting activities have made it both physically and mentally impossible for an accountant to be highly proficient in all of the areas of accounting. The data suggest that many local practitioners are providing services in areas in which they do not possess a good working knowledge.

Despite the fact that the average local CPA does not possess the necessary expertise to perform services in all the areas of accounting, the data infer that practitioners seldom consult with a specialist or recommend a referee. In fact the average practitioner is reluctant to refer his client to another CPA. The various interrelated factors which tend to discourage referrals appear to be (1) the fear of encroachment, (2) the lack of accreditation of specialists, and (3) the lack of an internal information reporting requirement. The general failure to recommend a referee adversely affects the best interest of both the client and the accounting profession. In fact, some practitioners would rather refer their client to a non-CPA rather than to another equally competent CPA due to the fear of encroachment.

The local CPA is also faced with an ethical constraint along with the competency limitation. The small businessman's demand, for example, for both independent auditing services and management advisory services pertaining to participating in the decision making process may result in a conflict of interest. The possibility of a conflict of interest situation is quite apparent when similar staff members perform both independent auditing services and management advisory services involving the decision making process for the same client.

Several steps can be taken in order to provide small business with relevant high quality accounting services.--

The data suggest that due to the attraction of small business entrepreneurs of greatly varying capabilities the failure rate of small businesses will tend to remain high. However, the overwhelming weight of the evidence indicates that several constructive steps may be taken by the accounting profession, the individual local practitioner, and the small businessman to improve the quality of accounting services and the operating efficiency of the average small firm.

The data imply that the accounting profession has the capability of helping small business to overcome its major deficiency of failing to gather and/or utilize accounting data from an adequate internal information system. Moreover, an immense social need exists for the small firms to be operated in a more efficient and economical manner rather than continuing the very high failure rate, plus continuing inefficient operations resulting in the uneconomical allocation of resources.

The recommendation is made that the local practitioner provide the small firm with the services for which the greatest need exists. The data suggest that the local practitioner can provide the small business with the greatest assistance by reviewing the firm's internal information system and reporting the results of such a review in the form of a mandatory internal information report. Such an

internal information report would be aimed at the small business' greatest deficiency and would be a great improvement over present services ranging from providing no assistance whatsoever beyond a short-form report to a management letter which describes the major deficiencies in the internal information system. The accounting profession appears to have a social obligation to provide an internal information report based on such factors as: (1) an immense need exists for such a report; (2) one major small business deficiency area pertains to one of the major accounting functions of adequate internal reporting; and (3) such an audit extension is both feasible and practical.

Various steps can also be taken to effectively combat the interrelated problems of possessing a minimum acceptable knowledge level, conflict of interest, and selecting a referee when the client needs one. The failure of the typical local practitioner to possess an acceptable knowledge level in certain phases of accounting leads to the need for accrediting specialists, establishing a formal referral system, adopting a continuing educational requirement, providing a larger selection of in-depth professional development courses, and adopting a five year minimum educational requirement.

The combination of a five year minimum educational program along with a mandatory continuing educational requirement would help to insure that a local practitioner is competent in his specific field of interest, plus assuring

that the beginning accountant does receive a satisfactory training program.

The data also suggest that a wider variety of in-depth progressional development courses need to be offered to the accounting professional especially in the new knowledge areas which greatly effect the local practitioner. It is also felt that universities could play a more active role in providing continuing educational programs to the accounting profession.

The recommendation is made that the American Institute of Certified Public Accountants adopt both a minimum acceptable EDP auditing knowledge level and a statistical sampling knowledge level in order to help insure that professional accountants possess a minimum acceptable knowledge level in strategic knowledge areas.

In order to encourage referrals, several steps can be taken to overcome the referral obstacles. The accreditation of specialists would enable one to identify competent individuals in a convenient manner and the requirement of an internal information report would identify the areas where outside help is needed. Moreover, the passage of an absolute ethical restraint clause would tend to overcome the fear of encroachment which is presently greatly hampering the actual recommendation of referee when the situation calls for such a recommendation.

Furthermore, a clause forbidding the giving and/or receiving of forwarding fees among CPAs except for services

rendered or responsibility shared would appear to tend to eliminate the possibility of making referrals based mainly on the prospective amount of forward fees rather than on the actual individual qualifications.

The evidence infers that small businesses should establish audit committees to review the CPAs work in order to prevent any possible conflict of interest especially in the situation where the practitioner is rendering management advisory services to competing clients. Additionally, local CPAs should provide for separate auditing and management advisory staffs when feasible in order to better guard against any possible conflict of interest either in fact or in appearance. However, it is noted that the overwhelming majority of local practitioners, especially the smaller CPAs, do not have separate management services departments and staffs nor do their clients have audit committees.

In summary, the individual practitioner and the accounting profession must take steps to insure that clients receive relevant services performed by competent individuals. An analysis and evaluation of the data developed in this paper along with an investigation of small business studies both seriously question the overall relevancy of selected current services provided by local practitioners plus suggest the quality of services rendered in many cases are not of the caliber expected of a professional accountant. The data suggest that the accounting profession, the individual CPA, and the small businessman can and should

take corrective steps in order to insure the rendering of a consistent professional quality of relevant services resulting in the more efficient overall operation of small businesses.

A look at the future local practitioner.--In all likelihood, the local practitioner of the future will cross a threshold. The accounting work of the future will doubtlessly be much more challenging and demanding with much less emphasis on detailed routine work. The future local practitioner will complete at least a five year educational program consisting of a heavy emphasis in quantitative techniques. Moreover, the behavioral sciences area will also receive more emphasis in future educational programs.

The creative thinker who can successfully implement his ideas will be at the forefront of his profession. The smaller local firm and the sole practitioner of the future will in all likelihood specialize in specific accounting areas including that of a generalist. Moreover, an adequate continuing educational program will be a must for all practitioners.

The projected growth in staff sizes with the resultant increase in specialization would appear to lead to the continuing establishment of separate management advisory service departments and in-house EDP facilities. In fact, approximately one-third of the larger CPA firms presently possess a separate management services department plus over

twenty per cent have in-house computer facilities.

The progressive local practitioner who provides his small business clients with relevant services will doubtlessly prosper. On the other hand, the less progressive practitioner will face an uncertain future. Some progressive data processing centers, for example, presently provide their clients with more relevant information than the local CPA who performs write-up work with the aid of manual equipment.

The overall future of the local practitioner, the accounting profession, and the small business will be largely determined by how well the institutions can adapt to the ever changing environment. The institutions which are able to successfully adapt to their environment should have a bright future while those who resist change may well see another more progressive institution providing the needed functions.

SELECTED BIBLIOGRAPHY

Books

Academic Preparation for Professional Accounting Careers.
New York: American Institute of Certified Public Accountants, Inc., 1968.

Accounting Research and Terminology Bulletins. final edition. New York: American Institute of Certified Public Accountants, Inc., 1961.

Achieving the Profession's Objectives: 1968 Report of Council to the Membership of the American Institute of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1968.

An Approach to the Use of EDP in an Accounting Practice-Computer Research Studies No. 6. New York: American Institute of Certified Public Accountants, Inc., 1968.

A Statement of Basic Accounting Theory. Evanston: American Accounting Association, 1966.

Bell, Robert W. Business Budgeting for Small Department Stores. Fayetteville: University of Arkansas, 1963.

Brown, Homer A., Jr. and Cummings, Alva A. Accounting and Financial Data for Retail Stores: Primary Purposes and Uses. Norman: University of Oklahoma, 1964.

Calder, Grant H. Small Business Counseling: An Evaluation of Techniques. Salt Lake City: The University of Utah, 1963.

Carey, John L. The CPA Plans for the Future. New York: American Institute of Certified Public Accountants, Inc., 1965.

_____. Professional Ethics of Certified Public Accountants. New York: American Institute of Certified Public Accountants, Inc., 1956.

- _____, and Doherty, William O. Ethical Standards of the Accounting Profession. New York: American Institute of Certified Public Accountants, Inc., 1966.
- Code of Professional Ethics and By-Laws. New York: American Institute of Certified Public Accountants, Inc., 1967.
- Davis, Gordon B. Auditing and EDP. New York: American Institute of Certified Public Accountants, Inc., 1968.
- Deran, Elizabeth Y. The Successful Shopkeeper: A Study of Retailer Survival in Nine Communities. Urbana: University of Illinois, 1963.
- DeRoover, Raymond, and Origo, Iris. "The Beginning of Double-Entry Bookkeeping in the Fourteenth Century," Vol. I of The World of Business. edited by Edward C. Bursk, Donald T. Clark, and Ralph W. Hidy. New York: Simon and Schuster, 1962.
- De Vois, Henry, ed. Management Services Handbook. New York: American Institute of Certified Public Accountants, Inc., 1964.
- Directory of Membership and Services--1968-1969. New York: Association of Consulting Management Engineers, Inc., 1968.
- Erwin, Robert D. Merchandise Management Accounting--A Guide to Item Profitability for Small and Medium Retail Stores. Stillwater: Oklahoma State University, 1964.
- Financial Statements Restated for General Price-Level Changes--Statement of the Accounting Principles Board--No. 3. New York: American Institute of Certified Public Accountants, Inc., 1969.
- Foulke, Roy A. Practical Financial Statement Analysis. 5th ed. New York: McGraw-Hill Book Company.
- Gibson, James L., and Haynes, W. Warren. Accounting in Small Business Decisions. Lexington: University of Kentucky Press, 1963.
- Grady, Paul. Inventory of Generally Accepted Accounting Principles for Business Enterprises--Accounting Research Study No. 7. New York: American Institute of Certified Public Accountants, Inc., 1965.

- Green, William E., Downer, R. Selby, and Cerny, Joseph. Case Studies in Management Counseling of Small Manufacturers. University, Mississippi: University of Mississippi, 1963.
- Hastings, Delbert C. The Place of Forecasting in Basic Planning for Small Business. Minneapolis: University of Minnesota, 1961.
- Heckert, J. Brooks, and Wilson, James D. Business Budgeting and Control. 3rd ed. New York: The Ronald Press Company, 1967.
- Holdren, Bob R., Buckberg, Albert, and Loomba, N. Paul. Operations Research in Small Business: A Case Study and Primer of Operations Research Techniques. Iowa City: University of Iowa, 1963.
- Hollander, Edward D. The Future of Small Business. New York: Frederick A. Praeger, Inc., 1967.
- Hood, William M., and Rasko, Peter. Management Factors Contributing to the Success or Failure of New Small Manufacturers. Ann Arbor: University of Michigan, 1964.
- Internal Control. New York: American Institute of Certified Accountants, 1949.
- Jackendoff, Nathaniel. A Study of Published Industry Financial and Operating Ratios. Philadelphia: Temple University, 1962.
- _____. The Use of Financial Techniques and Services by Small Business. Philadelphia: Temple University, 1961.
- Kline, John B., and Douth, John T. Case Problems of Small Businesses in the Rocky Mountain West. Boulder: University of Colorado, 1961.
- Kulas, Lidwik, Koppenhaver, R. D., and Clifford, Thomas J. The Development of Management Information for Small Manufacturers. Grand Forks: University of North Dakota, 1965.
- Lawyer, Kenneth. Small Business Success: Operating and Executive Characteristics. Cleveland: Western Reserve University, 1963.
- Lebreton, Preston P. A Guide for Proper Management Planning for Small Business. Baton Rouge: Louisiana State University Press, 1963.

MacNeill, James H., ed. Accounting Practice Management Handbook. New York: American Institute of Certified Public Accountants, 1962.

MAP 14d-Revenue and Expenses of Accounting Firms--Triennial Survey 1967. New York: American Institute of Certified Public Accountants, Inc., 1967.

Mautz, R. K., and Sharaf, Hussein A. The Philosophy of Auditing. Menosha: American Accounting Association, 1961.

McGuire, Joseph W. Factors Affecting the Growth of Manufacturing Firms. Seattle: University of Washington, 1963.

McKeever, John L. A Study of the Problems of Small Retailers in Wyoming. Laramie: University of Wyoming, 1960.

Megginson, Leon C. Personnel: A Behavioral Approach to Administration. Homewood: Richard D. Irwin, Inc., 1967.

Morrison, Karl. Management Counseling of Small Business in the United States. University, Mississippi: University of Mississippi, 1963.

Murphy, Mary E. Advanced Public Accounting Practice. Homewood: Richard D. Irwin, Inc., 1966.

Paustian, Paul W., and Lewis, John E., Jr. Small Business Instability and Failure in Alabama. University, Alabama: The University of Alabama, 1963.

Peters, William S. Patterns of Success for Selected Small Businesses in Arizona. Tempe: Arizona State University, 1962.

Pomeranz, Jamet M., and Prestwich, Leonard W. Meeting the Problems of Very Small Enterprises. Washington D. C.: George Washington University, 1962.

Pound, Roscoe. The Lawver from Antiquity to Modern Times. St. Paul: West Publishing Company, 1953.

Professional Development: Fall/Winter 1968-69 Courses, Lecture Programs, Training Programs. New York: American Institute of Certified Public Accountants, Inc., 1968.

Professional Development-1969. New York: American Institute of Certified Public Accountants, Inc., 1969.

Relationships Among CPAs, Banks and Service Bureaus--Computer Research Studies No. 4. New York: American Institute of Certified Public Accountants, Inc., 1966.

Ringstrom, N. H. Case Studies in Business Success and Failure. Stillwater: Oklahoma State University, 1962.

Roy, Robert H., and MacNeil, James H. Horizons for a Profession. New York: American Institute of Certified Public Accountants, Inc., 1967.

Siegal, S., and Fouraker, L. E. Bargaining and Group Decision Making: Experiments in Bilateral Monopoly. New York: McGraw-Hill, 1960.

Slavin, Alvert, and Armen, Seith Avakian. Small Business Accounting in Massachusetts-Practices and Problems. Boston: Northeastern University, 1962.

Solomon, Martin B., Jr. Investment Decisions in Small Business. Lexington: University of Kentucky Press, 1963.

Sprouse, Robert T., and Moonitz, Maurice. A Tentative Set of Broad Accounting Principles for Business Enterprises--Accounting Research Study No. 3. New York: American Institute of Certified Public Accountants, 1962.

Staff Training Program-Level I. New York: American Institute of Certified Public Accountants, Inc., 1969.

Statement on Management Advisory Services No. 1. New York: American Institute of Certified Public Accountants, Inc., 1969.

Trueblood, Robert M., Bedford, Norton M., Devore, Malcolm M., and Heimbucher, Clifford V. Profile of the Profession: 1975-Vol. II. New York: American Institute of Certified Public Accountants, 1965.

Woodruff, A. M., and Alexander, T. G. Success and Failure in Small Manufacturing. Pittsburgh: University of Pittsburgh Press, 1958.

Articles and Periodicals

"Accountants Turn Tougher." Business Week, October 18, 1969, pp. 124-130.

Adelson, Alan. "Whir, Blink--Jackpot! Crooked Operators Use Computers to Embezzle Money from Companies." The Wall Street Journal, April 5, 1968, 1.

"A Description of the Professional Practice of Certified Public Accountants." The Journal of Accountancy, CXXII (December, 1966), 61.

"AICPA Executive Committee Statement on Audit Committees of Boards of Directors." The Journal of Accountancy, CXXIV (September, 1967), 10.

Allen, Brandt. "Danger Ahead! Safeguard Your Computer." Harvard Business Review, XLVI (November-December, 1968), 97-101.

Axelson, Kenneth S. "Are Consulting and Auditing Compatible?" The Journal of Accountancy, CXIV (April, 1963), 54-64.

Bachrach, Michael D. "Co-operation in Services to Management." The Journal of Accountancy, CX (March, 1958), 37-39.

Beaver, William H. "Alternative Accounting Measures As Predictors of Failure." The Accounting Review, XLIII (January, 1968), 113-122.

Bedford, Norton M. "The Nature of Future Accounting Theory." The Accounting Review, XLII (January, 1967), 82-85.

Bevis, Herman W. "The CPA's Attest Function in Modern Society." The Journal of Accountancy, CXIII (February, 1962), 28-35.

Blough, Carman G. "Responsibility to Third Parties." The Journal of Accountancy, CIX (May, 1960), 58-65.

Briloff, Abraham J. "Old Myths and New Realities in Accountancy." The Accounting Review, XLI (July, 1966), 484-495.

"Business Counts the Casualties." Business Week, February 7, 1970, pp. 26-27.

Campfield, William L. "Trends in Auditing Management Plans and Operations." The Journal of Accountancy, CXXIV (July, 1967), 41-46.

Carey, John L. "Should CPA Firms Be Accredited?" The CPA, LXVII (June, 1967), 3-6.

- _____. "What Is the Professional Practice of Accounting?" The Accounting Review, XLIII (January, 1968), 1-9.
- _____, and Doherty, William O. "The Concept of Independence--Review and Restatement." The Journal of Accountancy, CXXI (January, 1966), 38-48.
- Carmichael, D. R., and Swieringa, R. J. "The Compatibility of Auditing Independence and Management Services--An Identification of Issues." The Accounting Review, XLIII (October, 1968), 697-705.
- Churchill, Neil C., and Cyert, Richard M. "An Experiment in Management Auditing." The Journal of Accountancy, CXXI (February, 1966), 39-43.
- _____, and Uretsky, Myron. "Management Accounting Tomorrow." Management Accounting, L (June, 1969), 46-53.
- Cohen, Manuel F. "The SEC and Accountants: Co-Operative Efforts to Improve Financial Reporting." The Journal of Accountancy, CXXII (December, 1966), 56-60.
- Cole, A. I. "Professional Co-operation in Referrals." The Canadian Chartered Accountant, LXXXIX (November, 1966), 341-344.
- "Council Approves Policy Requiring Five Years of College Study." The CPA, XLIX (June, 1969), 4-24.
- Cowperthwaite, Gordon H.; Corner, William R.; Anderson, Rodney J.; and Welch, G. Malcolm. "Computer Education and Chartered Accountant-Section 2." Canadian Chartered Accountant, special issue, (August, 1967), 43-49.
- _____; Corner, William R.; Anderson, Rodney J.; and Welch, G. Malcolm. "Educational Requirements of the Recommended Body of Knowledge-Section 6." Canadian Chartered Accountant, special issue (August, 1967), 50-55.
- _____; Corner, William R.; Anderson, Rodney J.; and Welch, G. Malcolm. "Practising Accountants and the Computer--Section 7." Canadian Chartered Accountant, special issue, (August, 1967), 23-32.
- Davidson, Sidney. "The Day of Reckoning--Managerial Analysis and Accounting Theory." Journal of Accounting Research, I (Autumn, 1963), 117-126.

- Devore, Malcolm M. "Compatibility of Auditing and Management Services--III. A Viewpoint From Within the Profession." The Journal of Accountancy, CXXIV (December, 1967), 36-39.
- Dey, Mukul K., and Kaur, Gurminder. "Facilitation of Performance by Experimentally Induced Ego Motivation." The Journal of General Psychology, LXXIII, (October, 1965), 237-247.
- Hakola, Vern E. "Computer Time-Sharing and the CPA--Opportunity or Problem?" The Journal of Accountancy, CXXVII (January, 1969), 63-68.
- Higgins, Thomas G. "Professional Ethics: A Time for Reappraisal." The Journal of Accountancy, CXIII (March, 1962), 29-35.
- Horrigan, James O. "A Short History of Financial Ratio Analysis." The Accounting Review, XLIII (April, 1968), 284-294.
- Humphrey, Mitchell O. "Management Letters--Image Builders for the CPA." The Journal of Accountancy, CXXIII (January, 1967), 27-32.
- Hunter, John A. "A Look at the Future." Louisiana Schools, April, 1969, pp. 3-6.
- Ijiri, Yuji. "On Budgeting Principles and Budget--Auditing Standards." The Accounting Review, XLIII (October, 1968), 662-667.
- "Intensive Math Course Geared for CPAs." The CPA, XLVII (October, 1967), 5.
- Johnson, Stuart J. "The Mark of An Educated Man." Phi Kappa Phi Journal, XLVII (Fall, 1968), 32-38.
- Kaufman, Felix. "Computer Time Sharing for the CPA." Management Services, (November-December, 1968), 17-29.
- Keller, Wayne. "Budgeting for Small Business." The Journal of Accountancy, CV (January, 1959), 44-49.
- Locke, Edwin A. "The Relationship of Intentions to Level of Performance." Journal of Applied Psychology, L, (February, 1966), 60-66.
- _____. "The Relationship of Task Success to Task Liking: A Replication." Psychological Reports, XVIII, (April, 1966), 552-554.

- _____, and Bryan, Judith F. "Performance Goals as Determinants of Level of Performance and Boredom." Journal of Applied Psychology, LI, (April, 1967), 120-129.
- Millar, Victor E. "The Three Levels of EDP Practice." The Journal of Accountancy, CXXIII (February, 1967), 41-44.
- "National Listing of Lawyers Available." Management Services, VI (March-April, 1969), 16.
- "New Group Formed to Set Consultant's Admission Standards." Management Services, VI (March-April, 1969), 6-8.
- "New Video-Tape PD Courses from Canada." The CPA, XLIX (January, 1969), 10.
- Paton, William A. "Accounting and Utilization of Resources." Journal of Accounting Research, I (Spring, 1963), 44-72.
- "PD Will Offer In-Depth Course on Computer Data Processing If Register by April 25," The CPA, LXIX (April, 1969), 6-15.
- Prestbo, John A. "More Individuals Buck Alarming Failure Rate to Start Own Firms." The Wall Street Journal, April 10, 1969, 1.
- "Professional Development." The CPA, XLVII (May, 1968), 11.
- Rea, Richard C. "Management Letters." The Journal of Accountancy, CXXIV (July, 1967), 75-76.
- _____. "The Management Letter." The Journal of Accountancy, CXXV (January, 1968), 74-76.
- "Reports Were Made to Council on Independence." The CPA, XLI (June, 1969), 8.
- Sargent, Arthur M. "Referrals." The Journal of Accountancy, CXVI (July, 1963), 40-45.
- Schley, Norman E. "Electronic Data Processing Is for Everyone." The Journal of Accountancy, CXXI (April, 1966), 74-79.
- Schulte, Arthur A., Jr. "Compatibility of Management Consulting and Auditing." The Accounting Review, XL (July, 1965), 587-593.

- _____. "Management Services: A Challenge to Audit Independence?" The Accounting Review, XLI (October, 1966), 721-728.
- Seidman, J. S. "The Obstacle to the Full Development of Referrals to Other Accountants." The New York Certified Public Accountant, XXXIII, (November, 1963), 754.
- Spring, Jack O. "CPA's Services to Management," The Texas CPA, XXXII (May, 1960), 33-34
- Stedry, Andrew C., and Day, Emanuel. "The Effects of Goal Difficulty on Performance: A Field Experiment." Behavioral Science, II (November, 1966), 459-469.
- Stone, Marvin L. "From the President." The CPA, XLVIII (April, 1968), 2.
- _____. "Specialization in the Accounting Profession." The Journal of Accountancy, CXXV (February, 1968), 25-29.
- Taylor, James W., and Dean, Neal J. "Managing to Manage the Computer." Harvard Business Review, XLIV (September-October, 1966), 98-110.
- "The Rising Pressures to Perform." Time, July 18, 1969, p. 75.
- Von Kaschnitz, Egon. "Management Letters for Clients of Small Accounting Firms." The Journal of Accountancy, CXXI (February, 1966), 33-38.
- Winston, Gerald. "Early Warning System for Business Managers." Management Services, VI (May-June, 1969), 28-36.
- Witschey, R. E. "The Accounting Function for Small Business." The Journal of Accountancy, CVII (December, 1958), 30-39.
- Webb, George. "Who Can Complain Now?" The Journal of Accountancy, CXXII (July, 1966), 78-80.
- Welsch, Glenn A.; Williams, Thomas H.; and Griffin, Charles H. "An Adventure in Learning for Certified Public Accountants." The Journal of Accountancy, CXXIII (March, 1967), 83-86.
- Westphal, William H. "The Future of the CPA in Tax Practice." The Journal of Accountancy, CXXVII (June, 1969), 40-44.

Whipple, Robert K. "Public Controllershship." The Journal of Accountancy, CXXVI (September, 1968), 79-80.

Wyant, Rowena. "Business Failures." Dun's Review, January, 1969, p. 85.

_____. "Business Failures." Dun's Review, March, 1969, pp. 115-116.

_____. "Business Failures." Dun's Review, October, 1968, p. 145.

Zakin, Noel. "The AICPA Responds to the Challenge of EDP." The Journal of Accountancy, CXXVII (March, 1969), 68-70.

Public Document

U. S. Treasury Department. Internal Revenue Service. Statistics of Income 1965--Business Income Tax Return. Washington, D. C.: Government Printing Office, 1968.

APPENDIX A

FACSIMILES OF THE LOUISIANA LOCAL FIRM, LOUISIANA
SOLE PRACTITIONER, AND NATIONAL CPA FIRM WITH
OFFICES IN LOUISIANA QUESTIONNAIRES

To: Sole Practitioner or Managing Partner

LOCAL PRACTITIONER QUESTIONNAIRE

Your firm has been selected to be included in a sample of local practitioners located in Louisiana. The purpose of this questionnaire is to determine the role of the local practitioner in our society. The results of the survey are expected to be published with recommendations as to how various institutions may design programs and change rules in order to aid and help the local practitioner. In order to obtain a representative sample of local practitioners, it is imperative that you answer this questionnaire. Local practitioner for this study is defined as a sole practitioner or a local firm.

The questionnaire is designed to be completed in a minimum of time and the estimated time to complete is 30 to 40 minutes. All replies are to be held strictly confidential and it is optional whether or not you supply your firm's name. Please answer the questions based upon the experience of your firm.

Please complete and return in the self addressed envelope to:

Dr. William E. Swyers
Louisiana State University
School of Business Administration
Department of Accounting
Baton Rouge, Louisiana 70803

To: Senior Partner of Local Firm

LOCAL PRACTITIONER QUESTIONNAIRE

Several weeks ago you were chosen to be included in a sample group of local practitioners located in Louisiana. If you have not already done so please answer this questionnaire so that your views will be recorded on these controversial issues. If you have already answered this questionnaire your help and consideration is greatly appreciated.

The purpose of this questionnaire is to determine the role of the local practitioner in our society. The results of the survey are expected to be published with recommendations as to how various institutions may design programs and change rules in order to aid and help the local practitioner. In order to obtain a representative sample of local practitioners, it is imperative that you answer this questionnaire. Local practitioner for this study is defined as a local firm with offices confined to the state of Louisiana.

The questionnaire is designed to be completed in a minimum of time and the estimated time to complete it is 30 to 40 minutes. All replies are to be held strictly confidential and it is optional whether or not you supply your firm's name. Please answer the questions based upon the experience of your firm.

Please complete and return in the self addressed

stamped envelope to:

Dr. William E. Swyers
Louisiana State University
School of Business Administration
Department of Accounting
Baton Route, Louisiana 70803

Thank you for your consideration and help.

Part I. Referrals

1. Indicate the method or methods which you use in selecting referral firms.
a) directory of management consultants; b) personal observation of prior work by others; c) suggestions by a banker or lawyer; d) personal acquaintance; e) rely on reputation of a national C.P.A. firm; f) rely on reputation of a local C.P.A. firm; g) other. Please state _____.
2. Have you ever had the experience of referring work to another C.P.A. who subsequently extended his services to areas formerly performed by you yourself?
____ yes ____ no ____ have never referred work to a C.P.A.
3. If the answer is yes, describe the frequency of such occurrence?
____ number of times occurred.
4. If a client requests you to extend your services to an area which is now performed by the C.P.A. firm which referred you to the client, would you extend your services after consulting with the referring C.P.A. firm?
____ yes ____ no
5. Assume that during the course of your audit that you noticed that your client has a problem in an area which you are not competent in. Would you feel an obligation to inform your client of the problem and refer him to a C.P.A. who is competent in the problem area?
____ yes ____ no
6. Will your firm accept referrals from another C.P.A. firm?
____ yes ____ no
7. Have you ever had a referral rejected by another local practitioner?
____ yes ____ no ____ no experience in this area
8. Have you ever had a referral rejected by a national firm?
____ yes ____ no ____ no experience in this area
9. Are you reluctant to refer your client to another C.P.A. due to the fact you perceive that he will probably extend his services to areas you now perform?
____ yes ____ no
10. Do you ever enter into agreements with a firm to whom you have referred a client "not to extend services?"
____ yes ____ no ____ no experience in this area
11. Do you ever combine staffs with other local practitioners in order to perform management services work?
____ yes ____ no
12. Do you ever give and/or receive forwarding fees from C.P.A. firms for referral services?
____ yes ____ no ____ no experience in this area
If yes, does the client ultimately pay for this service in the form of a higher total bill?
____ yes ____ no
13. If you do receive or give a forwarding fee to another C.P.A., which of the following factors are the basis of the fee:
a) time spent in locating the firm to whom you will refer your client; b) courtesy for referring client; c) other. Please identify _____
14. At present would you rather recommend to your client a C.P.A. or an equally competent outside consultant?
____ C.P.A. ____ outside consultant ____ no preference
15. Rule 3.04 of the rule of Professional Conduct states that "a member or associate who receives an engagement for services by referral from another member or associate shall not discuss or accept an extension of his services beyond the specific engagement without first consulting with the referring member or associate." Do you believe that this rule adequately protects a C.P.A. firm from encroachment by a referred firm?
____ yes ____ no

6. Would you be interested in attending a seminar at a Louisiana University with the subject matter geared to the needs of the local practitioner?
 ___ yes ___ no
7. If your answer was yes to the above question, which of the following areas would you be interested in:
 ___ Taxation of individuals and corporations
 ___ Taxation of estates
 ___ Computer languages such as COBOL
 ___ Auditing the computer
 ___ Statistical sampling techniques
 ___ Integrated case studies
 ___ Systems analysis
 ___ Accountant's legal responsibility
 ___ Operations research techniques
 ___ Other Please state _____
8. How much in terms of time and percentage of gross fees does your firm spend per year for professional development?
 ___ days per partner
 ___ days per staff man
 ___ percentage of gross fees of firm

Part III. Management Services

1. Do you have a separate management services department?
 ___ yes ___ no
 If yes, did you have one three years ago?
 ___ yes ___ no
 If no, do you plan to have one three years from now?
 ___ yes ___ no
2. Do you have any full time management services personnel?
 ___ yes ___ no
 If yes, please indicate their areas of speciality.

3. If you perform both management services work and render an opinion on financial statements for the same client, is the same partner in charge of both services?
 ___ always ___ frequently ___ occasionally ___ never
4. If you notice during the course of your audit a deficiency in the information system for internal planning and decision making such as the failure to use the optimum combination of channels of distribution, would you inform your client about this fact?
 ___ always ___ frequently ___ occasionally ___ never
5. Would your firm render management services to competing clients in similar decision making areas such as a review of pricing policies?
 ___ yes ___ no
6. Do any of your clients have an "audit committee" to review your management services work?
 ___ yes ___ no
7. Do your audit programs contain a check sheet for the purpose of examining the firm's information system for internal planning and control?
 ___ yes ___ no
8. Do you think that the majority of your clients have a need for some type of management services work?
 ___ yes ___ no
9. Do you describe the type of management service work you perform to your clients?
 ___ yes ___ no ___ do not perform management services work

- | | <u>Group One</u> | <u>Group Two</u> | <u>Group Three</u> |
|---|-------------------|-----------------------|--------------------|
| | <u>Extent</u> | <u>Projected</u> | <u>Service</u> |
| | <u>Performed</u> | <u>Demand</u> | <u>Requested</u> |
| | <u>By</u> | <u>For Services</u> | <u>By</u> |
| | <u>You</u> | <u>In Three Years</u> | <u>Client</u> |
| <u>Type of Service</u> | <u>Never Occ.</u> | <u>Same More Less</u> | <u>Never Occ.</u> |
| | <u>Freq.</u> | | <u>Freq.</u> |
| MANAGERIAL STUDIES | | | |
| 1. Analysis of adding or dropping
a product or department..... | _____ | _____ | _____ |
| 2. Assistance in direct costing
techniques..... | _____ | _____ | _____ |
| 3. Assistance in incremental
costing techniques..... | _____ | _____ | _____ |
| 4. Assistance in advising whether
or not one should start a
business..... | _____ | _____ | _____ |
| 5. Budgets..... | _____ | _____ | _____ |
| 6. Buy or make analysis..... | _____ | _____ | _____ |
| 7. Cost allocation..... | _____ | _____ | _____ |
| 8. Economic order quantity
analysis..... | _____ | _____ | _____ |
| 9. Financing arrangements..... | _____ | _____ | _____ |
| 10. Insurance analysis..... | _____ | _____ | _____ |
| 11. Inventory control analysis..... | _____ | _____ | _____ |
| 12. Management audit-evaluation
of management..... | _____ | _____ | _____ |
| 13. Mergers and/or reorganization.. | _____ | _____ | _____ |
| 14. Replacement analysis and/or
purchase of new facilities.... | _____ | _____ | _____ |
| 15. Review of organization
structure | _____ | _____ | _____ |
| 16. Analysis of non-recurring
problems not mentioned above... | _____ | _____ | _____ |
| SYSTEMS | | | |
| 1. Review feasibility of use of a
punched card system..... | _____ | _____ | _____ |
| 2. Reviewing computer proposals... | _____ | _____ | _____ |
| 3. Performing computer feasibility
studies..... | _____ | _____ | _____ |
| 4. Supervising computer
installation projects..... | _____ | _____ | _____ |
| 5. Systems analysis..... | _____ | _____ | _____ |
| MARKETING | | | |
| 1. Market analysis..... | _____ | _____ | _____ |
| 2. Sales management; prices,
channels of distribution..... | _____ | _____ | _____ |
| 3. Sales forecasting..... | _____ | _____ | _____ |
| PERSONNEL | | | |
| 1. Evaluation of personnel..... | _____ | _____ | _____ |
| 2. Selection of personnel..... | _____ | _____ | _____ |
| 3. Training of personnel..... | _____ | _____ | _____ |
| 4. Analysis of wage compensation
plan..... | _____ | _____ | _____ |
| MATHEMATICAL TECHNIQUES | | | |
| 1. Break-even analysis..... | _____ | _____ | _____ |
| 2. Capital budgeting..... | _____ | _____ | _____ |
| 3. Linear programming..... | _____ | _____ | _____ |
| 4. Multiple regression..... | _____ | _____ | _____ |
| 5. Simulation..... | _____ | _____ | _____ |
| 6. Operations research techniques
not mentioned above..... | _____ | _____ | _____ |

Part IV. General

1. Listed below are the general types of work performed by local practitioners. Please indicate the percentage of work performed in each area and the per cent of gross fees derived from each area for the years 1965 and 1968 plus project the type of services you expect to perform three years from now.

Types of Services Performed	Per Cent of Services Performed In			Per Cent of Gross Fees Derived From		
	1965	1968	1971	1965	1968	1971
1. Auditing.....	___	___	___	___	___	___
2. Estate planning.....	___	___	___	___	___	___
3. General tax work.....	___	___	___	___	___	___
4. Management services.....	___	___	___	___	___	___
5. Write-up work.....	___	___	___	___	___	___
6. Other.....	___	___	___	___	___	___

2. Listed below are types of services sometimes provided in conjunction with the rendering of an opinion on financial statements. Please indicate the frequency of providing each type of service with certification.

Type of Service	Frequency Provided			
	Never	Occ.	Freq.	Always
1. Compute pertinent ratios.....	___	___	___	___
2. Compare present ratios with prior ratios	___	___	___	___
3. Compare clients ratios with industry ratios.....	___	___	___	___
4. Written explanation of possible reasons why ratios are outside of tolerance limits.....	___	___	___	___
5. Comparison of actual results with budgeted figures.....	___	___	___	___
6. Provide management letter describing deficiencies in the information for internal planning, control, and decision making.....	___	___	___	___

3. Please indicate the extent of reading the following professional magazines.

Magazines	Extent of Reading			
	Never	Occasionally Read An Article	Regularly Read One Or More Articles	Generally Read Almost All Articles
1. Harvard Business Review.....	___	___	___	___
2. Management Accounting.....	___	___	___	___
3. Management Services.....	___	___	___	___
4. Taxes-The Tax Magazine.....	___	___	___	___
5. Taxation for Accountants.....	___	___	___	___
6. The Accounting Review.....	___	___	___	___
7. The Journal of Accountancy.....	___	___	___	___
8. The Journal of Taxation.....	___	___	___	___
9. The Louisiana Certified Public Accountant.....	___	___	___	___

4. Indicate the extent of your participation in professional activities.
 ___ extensive ___ more than average ___ rarely participate

5. Do you use any of the following computer aids in your firm?

___ in house computer facilities
 ___ time sharing computers with remote terminals
 ___ computer service center for processing data
 ___ computer prepared tax returns

6. Do your clients use the facilities of a computer in processing and analyzing their data?

___ none use the computer
 ___ few use the computer
 ___ most use the computer
 ___ all use the computer

7. If some of your clients use some form of computer facilities, were you instrumental in persuading your client to use computer facilities?

___ yes ___ no ___ none use computer

8. Please provide the following information about the members of your firm.
- ☐ number of partners
 - ☐ number of professional staff with C.P.A. certificate
 - ☐ number of professional staff without C.P.A. certificate
 - ☐ number of non-professional staff
 - ☐ age of firm
9. Indicate the extent of your participation in community activities.
- ☐ extensive ☐ more than average ☐ rarely participate
10. Does either statement below pertain to any of your clients?
- ☐ Client has an office in a state other than Louisiana.
 - ☐ Client is engaged in foreign operations.
11. Indicate your firm's experiences with the American Institute of Certified Public Accountants' self study technical studies pertaining to management services and federal taxation.
- ☐ Studies are very helpful guides.
 - ☐ Studies are fair guides.
 - ☐ Studies are not pertinent for use by a local practitioner.
 - ☐ Studies have not been used as a self study tool.
12. Name (OPTIONAL) _____

To: Sole Practitioner or Managing Partner

LOCAL PRACTITIONER QUESTIONNAIRE

Your firm has been selected to be included in a sample of local practitioners located in Louisiana. The purpose of this questionnaire is to determine the role of the local practitioner in our society. The results of the survey are expected to be published with recommendations as to how various institutions may design programs and change rules in order to aid and help the local practitioner. In order to obtain a representative sample of local practitioners, it is imperative that you answer this questionnaire. Local practitioner for this study is defined as a sole practitioner or a local firm.

The questionnaire is designed to be completed in a minimum of time and the estimated time to complete is 30 to 40 minutes. All replies are to be held strictly confidential and it is optional whether or not you supply your firm's name. Please answer the questions based upon the experience of your firm.

Please complete and return in the self addressed envelope to:

Dr. William E. Swyers
Louisiana State University
School of Business Administration
Department of Accounting
Baton Rouge, Louisiana 70803

To: Sole Practitioner

LOCAL PRACTITIONER QUESTIONNAIRE

Several weeks ago you were chosen to be included in a sample group of local practitioners located in Louisiana. If you have not already done so please answer this questionnaire so that your views will be recorded on these controversial issues. If you have already answered the questionnaire, your help and consideration are greatly appreciated. If you are not a full time local practitioner, please return the questionnaire marked "not applicable."

The purpose of this questionnaire is to determine the role of the local practitioner in our society. The results of the survey are expected to be published with recommendations as to how various institutions may design programs and change rules in order to aid and help the local practitioner. Local practitioner for this study is defined as a sole practitioner or a local firm.

The questionnaire is designed to be completed in a minimum of time and the estimated time to complete it is 30 to 40 minutes. All replies are to be held strictly confidential and it is optional whether or not you supply your firm's name. Please answer the questions based upon the experience of your firm.

Please complete and return in the self addressed
stamped envelope to:

Dr. William E. Swyers
Louisiana State University
School of Business Administration
Department of Accounting
Baton Route, Louisiana 70803

Thank you for your consideration and help.

Part I. Referrals

1. Indicate the method or methods which you use in selecting referral firms.
 a) directory of management consultants; b) personal observation
of prior work by others; c) suggestions by a banker or lawyer;
 d) personal acquaintance; e) rely on reputation of a national
C.P.A. firm; f) rely on reputation of a local C.P.A. firm;
 g) other. Please state _____.
2. Have you ever had the experience of referring work to another C.P.A.
who subsequently extended his services to areas formerly performed by
you yourself?
 yes no have never referred work to a C.P.A.
3. If the answer is yes, describe the frequency of such occurrence?
 number of times occurred.
4. If a client requests you to extend your services to an area which is
now performed by the C.P.A. firm which referred you to the client,
would you extend your services after consulting with the referring
C.P.A. firm?
 yes no
5. Assume that during the course of your audit that you noticed that
your client has a problem in an area which you are not competent in.
Would you feel an obligation to inform your client of the problem
and refer him to a C.P.A. who is competent in the problem area?
 yes no
6. Will your firm accept referrals from another C.P.A. firm?
 yes no
7. Have you ever had a referral rejected by another local practitioner?
 yes no no experience in this area
8. Have you ever had a referral rejected by a national firm?
 yes no no experience in this area
9. Are you reluctant to refer your client to another C.P.A. due to the
fact you perceive that he will probably extend his services to areas
you now perform?
 yes no
10. Do you ever enter into agreements with a firm to whom you have
referred a client "not to extend services?"
 yes no no experience in this area
11. Do you ever combine staffs with other local practitioners in order to
perform management services work?
 yes no
12. Do you ever give and/or receive forwarding fees from C.P.A. firms for
referral services?
 yes no no experience in this area
If yes, does the client ultimately pay for this service in the form
of a higher total bill?
 yes no
13. If you do receive or give a forwarding fee to another C.P.A., which
of the following factors are the basis of the fee:
 a) time spent in locating the firm to whom you will refer your client;
 b) courtesy for referring client; c) other. Please identify

14. At present would you rather recommend to your client a C.P.A. or an
equally competent outside consultant?
 C.P.A. outside consultant no preference
15. Rule 3.04 of the rule of Professional Conduct states that "a member or
associate who receives an engagement for services by referral from
another member or associate shall not discuss or accept an extension
of his services beyond the specific engagement without first consulting
with the referring member or associate." Do you believe that this
rule adequately protects a C.P.A. firm from encroachment by a referred
firm?
 yes no

- yes no

6. Would you be interested in attending a seminar at a Louisiana University with the subject matter geared to the needs of the local practitioner?
 ___ yes ___ no
7. If your answer was yes to the above question, which of the following areas would you be interested in:
 ___ Taxation of individuals and corporations
 ___ Taxation of estates
 ___ Computer languages such as COBOL
 ___ Auditing the computer
 ___ Statistical sampling techniques
 ___ Integrated case studies
 ___ Systems analysis
 ___ Accountant's legal responsibility
 ___ Operations research techniques
 ___ Other Please state _____
8. How much in terms of time and percentage of gross fees does your firm spend per year for professional development?
 ___ days per partner
 ___ days per staff man
 ___ percentage of gross fees of firm

Part III. Management Services

1. Do you have a separate management services department?
 ___ yes ___ no
 If yes, did you have one three years ago?
 ___ yes ___ no
 If no, do you plan to have one three years from now?
 ___ yes ___ no
2. Do you have any full time management services personnel?
 ___ yes ___ no
 If yes, please indicate their areas of speciality.

3. If you perform both management services work and render an opinion on financial statements for the same client, is the same partner in charge of both services?
 ___ always ___ frequently ___ occasionally ___ never
4. If you notice during the course of your audit a deficiency in the information system for internal planning and decision making such as the failure to use the optimum combination of channels of distribution, would you inform your client about this fact?
 ___ always ___ frequently ___ occasionally ___ never
5. Would your firm render management services to competing clients in similar decision making areas such as a review of pricing policies?
 ___ yes ___ no
6. Do any of your clients have an "audit committee" to review your management services work?
 ___ yes ___ no
7. Do your audit programs contain a check sheet for the purpose of examining the firm's information system for internal planning and control?
 ___ yes ___ no
8. Do you think that the majority of your clients have a need for some type of management services work?
 ___ yes ___ no
9. Do you describe the type of management service work you perform to your clients?
 ___ yes ___ no ___ do not perform management services work

Part IV. General

1. Listed below are the general types of work performed by local practitioners. Please indicate the percentage of work performed in each area and the per cent of gross fees derived from each area for the years 1965 and 1968 plus project the type of services you expect to perform three years from now.

Types of Services Performed	Per Cent of Services Performed In			Per Cent of Gross Fees Derived From		
	1965	1968	1971	1965	1968	1971
1. Auditing.....	___	___	___	___	___	___
2. Estate planning.....	___	___	___	___	___	___
3. General tax work.....	___	___	___	___	___	___
4. Management services.....	___	___	___	___	___	___
5. Write-up work.....	___	___	___	___	___	___
6. Other.....	___	___	___	___	___	___

2. Listed below are types of services sometimes provided in conjunction with the rendering of an opinion on financial statements. Please indicate the frequency of providing each type of service with certification.

Type of Service	Frequency Provided			
	Never	Occ.	Freq.	Always
1. Compute pertinent ratios.....	___	___	___	___
2. Compare present ratios with prior ratios	___	___	___	___
3. Compare clients ratios with industry ratios.....	___	___	___	___
4. Written explanation of possible reasons why ratios are outside of tolerance limits.....	___	___	___	___
5. Comparison of actual results with budgeted figures.....	___	___	___	___
6. Provide management letter describing deficiencies in the information for internal planning, control, and decision making.....	___	___	___	___

3. Please indicate the extent of reading the following professional magazines.

Magazines	Never	Extent of Reading		
		Occasionally Read An Article	Regularly Read One Or More Articles	Generally Read Almost All Articles
1. Harvard Business Review.....	___	___	___	___
2. Management Accounting.....	___	___	___	___
3. Management Services.....	___	___	___	___
4. Taxes-The Tax Magazine.....	___	___	___	___
5. Taxation for Accountants.....	___	___	___	___
6. The Accounting Review.....	___	___	___	___
7. The Journal of Accountancy.....	___	___	___	___
8. The Journal of Taxation.....	___	___	___	___
9. The Louisiana Certified Public Accountant.....	___	___	___	___

4. Indicate the extent of your participation in professional activities.
 ___ extensive ___ more than average ___ rarely participate

5. Do you use any of the following computer aids in your firm?
 ___ in house computer facilities
 ___ time sharing computers with remote terminals
 ___ computer service center for processing data
 ___ computer prepared tax returns

6. Do your clients use the facilities of a computer in processing and analyzing their data?
 ___ none use the computer
 ___ few use the computer
 ___ most use the computer
 ___ all use the computer

7. If some of your clients use some form of computer facilities, were you instrumental in persuading your client to use computer facilities?
 ___ yes ___ no ___ none use computer

8. Please provide the following information about the members of your firm.

____ number of partners
____ number of professional staff with C.P.A. certificate
____ number of professional staff without C.P.A. certificate
____ number of non-professional staff
____ age of firm

9. Indicate the extent of your participation in community activities.

____ extensive ____ more than average ____ rarely participate

10. Are you a full time local practitioner?

____ yes ____ no

11. Name (OPTIONAL) _____

To: Managing Martner

NATIONAL C.P.A. FIRM QUESTIONNAIRE

The purpose of this questionnaire is to determine the relationships of national Certified Public Accounting firms with local practitioners located in the state of Louisiana. The results of this and other surveys are expected to be published. The purpose of the study is to determine the role played by local practitioners in our society along with an analysis of how local practitioners may improve their service to their clients. Local practitioners for the purpose of this study are defined as a sole practitioner or a local firm.

The estimated time to complete the questionnaire is 10 to 20 minutes. All replies are to be held strictly confidential and it is optional whether or not you supply your firm's name.

Please complete and return questionnaire in the self addressed envelope to:

Dr. William E. Swyers
Louisiana State University
School of Business Administration
Department of Accounting
Baton Rouge, La. 70803

1. Will your firm accept referrals from local practitioners?
☐yes ☐no
2. Does your firm ever receive referrals from local Louisiana practitioners?
☐never ☐occasionally
☐frequently
3. Do you ever engage in cooperative efforts with local C.P.A.'s for the purpose of performing management services work?
☐yes ☐no
4. Do you ever explain the type of management services you perform to local practitioners?
☐never ☐occasionally
☐frequently
5. Does your firm ever act in the capacity of a controller for a small firm?
☐yes ☐no
6. If the answer to the question 5 is yes, if you also certify the statements for the firm, will the same partner be in charge of the audit?
☐always ☐never
☐occasionally ☐frequently
7. If a client requests you to extend your services to an area which is now performed by a local practitioner who referred you to the client, would you extend your services after consulting with the referring local practitioner?
☐yes ☐no
8. Will you ever enter into agreements with local practitioners who referred work to you "not to extend services?"
☐yes ☐no

APPENDIX B

SUMMARIZATION OF RESPONSES TO QUESTIONNAIRES NOT PRESENTED IN THE MAIN BODY OF THE PAPER

TABLE 41

ANALYSIS OF THE COMPOSITION OF LOUISIANA LOCAL CPA FIRM

<u>General Information</u>	Composition Of CPA Firm According To A Professional Staff Of		
	<u>1-5</u>	<u>6-10</u>	<u>over 10</u>
1. Number of partners	1.4	2.4	4.9
2. Number of professional staff with CPA certificate	0.2	0.9	2.4
3. Number of professional staff without CPA certificate	1.3	3.7	9.2
4. Number of Non-professional staff	1.4	1.7	4.4
5. Age of firm in years	14	14	22

TABLE 42

ANALYSIS OF THE EXTENT OF PARTICIPATION BY
LOUISIANA LOCAL PRACTITIONERS IN COMMUNITY
AND PROFESSIONAL ACTIVITIES

<u>Type Of Participation</u>	Degree Of Participation Expressed As A Percentage According To A Professional Staff Of								
	1-5			6-10			over 10		
	<u>EX</u>	<u>MA</u>	<u>RP</u>	<u>EX</u>	<u>MA</u>	<u>RP</u>	<u>EX</u>	<u>MA</u>	<u>RP</u>
1. Professional activities	7	37	56	22	34	44	54	33	13
2. Community activities	28	47	25	22	50	28	30	54	16

Note: EX, MA, and RP are abbreviations for Extensive, More Than Average, Rarely Participate, respectively.

TABLE 43

ANALYSIS TO DETERMINE WHETHER LOUISIANA LOCAL
PRACTITIONERS WERE INSTRUMENTAL IN
PERSUADING CLIENTS WITH COMPUTER
FACILITIES TO INSTALL
SUCH EQUIPMENT

<u>Question</u>	Degree Of Participation Expressed As A Percentage According To A Professional Staff of					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. If some of your clients use some form of computer facilities were you in- strumental in persuading your client to use com- puter facilities?	74	26	69	31	70	30

Note: The percentages only pertain to the local practitioners who have clients with computer facilities.

TABLE 44

ANALYSIS OF HOW THE LOUISIANA LOCAL PRACTITIONERS
PERCEIVE CLIENT'S NEED FOR MANAGEMENT
SERVICES WORK AND THE FREQUENCY
WITH WHICH TYPES OF MANAGEMENT
SERVICES ARE EXPLAINED
TO CLIENTS

<u>Question</u>	Degree Of Frequency Expressed As A Percentage According To A Professional Staff Of					
	1-5		6-10		over 10	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. Do you think that the majority of your clients have a need for some type of management services work?	71	29	94	6	93	7
2. Do you describe the type of management service work you perform to your clients?	53	47	53	47	78	22

Note: The percentages in Question Two only pertain to the local practitioners who state they perform management services.

TABLE 45

ANALYSIS TO DETERMINE WHETHER OR NOT LOUISIANA
LOCAL PRACTITIONERS WHO GIVE AND/OR
RECEIVE FORWARDING FEES MAKE
THEIR CLIENTS PAY FOR THIS
SERVICE IN HIGHER THAN
NORMAL FEES

<u>Question</u>	Degree Of Occurrence Expressed As A Percentage According To A Professional Staff Of					
	<u>1-5</u>		<u>6-10</u>		<u>over 10</u>	
	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>	<u>Yes</u>	<u>No</u>
1. If you ever give and/or receive forward fees from CPA firms for refer- ral services, does the client ultimately pay for this service in the form of a higher total bill?	0	100	0	100	0	100

TABLE 46

ANALYSIS OF THE BASIS FOR DETERMINING
THE AMOUNT OF THE FORWARDING FEE

<u>Basis For Fees</u>	Frequency Of Occurrence Expressed As A Percentage According To A Professional Staff Of		
	<u>1-5</u>	<u>6-10</u>	<u>over 10</u>
1. Time spent in locating the firm to whom you will refer your client	25	0	0
2. Courtesy for referring client . .	25	100	0
3. Other	50	0	100 .

TABLE 47

ANALYSIS OF LOUISIANA LOCAL PRACTITIONERS WHO
HAVE EXPERIENCED ENCROACHMENT IN ORDER
TO DETERMINE THE FREQUENCY OF
SUCH ENCROACHMENT

<u>Question</u>	Degree Of Occurrence Of Encroachment According To A Professional Staff Of		
	<u>1-5</u>	<u>6-10</u>	<u>over 10</u>
1. If you have ever had the experience of referring work to another CPA who subsequently extended his services to areas formerly performed by you yourself, describe the frequency of such occurrence	2.0	1.5	N/A

Note: N/A is an abbreviation for none of the CPA firms over ten have experienced an encroachment.

TABLE 48

ANALYSIS OF PERCENTAGE OF GROSS FEES BY TYPE
OF SERVICES DERIVED OR EXPECTED TO BE
DERIVED BY LOUISIANA LOCAL
PRACTITIONERS FOR THE YEARS
1965, 1968, AND 1971

<u>Type of Services</u>	Degree Of Occurrence Expressed As A Percentage According To A Professional Staff Of								
	1-5			6-10			over 10		
	<u>65</u>	<u>68</u>	<u>71</u>	<u>65</u>	<u>68</u>	<u>71</u>	<u>65</u>	<u>68</u>	<u>71</u>
1. Auditing	29	33	38	31	35	39	34	37	37
2. Estate planning	3	4	5	7	8	9	5	6	7
3. General tax work	30	32	32	27	24	24	28	27	25
4. Management services	5	7	8	6	7	10	5	8	11
5. Write-up work	29	21	14	28	24	16	21	14	9
6. Other	4	3	3	1	2	2	7	8	11

Note: 65, 68, and 71 are abbreviations for 1965, 1968, and 1971, respectively.

TABLE 49

ANALYSIS OF THE EXTENT TO WHICH CLIENTS OF
LOUISIANA LOCAL PRACTITIONERS REQUEST
SELECTED SERVICES

<u>Type Of Service</u>	Degree Of Occurrence Expressed As A Percentage According To A Professional Staff Of								
	1-5			6-10			over 10		
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>
MANAGERIAL STUDIES									
1. Analysis of adding or dropping a product or department	<u>45</u>	<u>55</u>	<u>0</u>	<u>31</u>	<u>69</u>	<u>0</u>	<u>30</u>	<u>62</u>	<u>8</u>
2. Assistance in direct costing techniques	<u>45</u>	<u>52</u>	<u>3</u>	<u>31</u>	<u>69</u>	<u>0</u>	<u>30</u>	<u>70</u>	<u>0</u>
3. Assistance in incremental costing techniques	<u>58</u>	<u>37</u>	<u>5</u>	<u>75</u>	<u>25</u>	<u>0</u>	<u>46</u>	<u>46</u>	<u>8</u>
4. Assistance in advising whether or not one should start a business	<u>10</u>	<u>63</u>	<u>27</u>	<u>19</u>	<u>75</u>	<u>6</u>	<u>0</u>	<u>54</u>	<u>46</u>
5. Budgets	<u>25</u>	<u>60</u>	<u>15</u>	<u>13</u>	<u>81</u>	<u>6</u>	<u>15</u>	<u>70</u>	<u>15</u>
6. Buy or make analysis	<u>50</u>	<u>37</u>	<u>13</u>	<u>63</u>	<u>37</u>	<u>0</u>	<u>46</u>	<u>46</u>	<u>8</u>
7. Cost allocation	<u>47</u>	<u>40</u>	<u>13</u>	<u>19</u>	<u>75</u>	<u>6</u>	<u>0</u>	<u>92</u>	<u>8</u>
8. Economic order quantity analysis	<u>68</u>	<u>22</u>	<u>0</u>	<u>69</u>	<u>31</u>	<u>0</u>	<u>85</u>	<u>15</u>	<u>0</u>
9. Financing arrangements	<u>7</u>	<u>66</u>	<u>27</u>	<u>6</u>	<u>44</u>	<u>50</u>	<u>0</u>	<u>37</u>	<u>63</u>
10. Insurance analysis	<u>17</u>	<u>70</u>	<u>13</u>	<u>6</u>	<u>81</u>	<u>13</u>	<u>15</u>	<u>54</u>	<u>31</u>
11. Inventory control analysis	<u>37</u>	<u>53</u>	<u>10</u>	<u>19</u>	<u>75</u>	<u>6</u>	<u>0</u>	<u>62</u>	<u>38</u>
12. Management audit-evaluation of management	<u>75</u>	<u>22</u>	<u>13</u>	<u>63</u>	<u>37</u>	<u>0</u>	<u>30</u>	<u>62</u>	<u>8</u>
13. Mergers and/or reorganization . .	<u>45</u>	<u>55</u>	<u>0</u>	<u>19</u>	<u>68</u>	<u>13</u>	<u>0</u>	<u>62</u>	<u>38</u>
14. Replacement analysis and/or purchase of new facilities	<u>25</u>	<u>75</u>	<u>0</u>	<u>37</u>	<u>57</u>	<u>6</u>	<u>8</u>	<u>70</u>	<u>22</u>

TABLE 49 (Continued)

Type Of Service	Degree Of Occurrence Expressed As A Percentage According To A Professional Staff Of								
	1-5			6-10			over 10		
	N	OC	FR	N	OC	FR	N	OC	FR
15. Review of organization structure	<u>32</u>	<u>68</u>	<u>0</u>	<u>25</u>	<u>75</u>	<u>0</u>	<u>0</u>	<u>92</u>	<u>8</u>
16. Analysis of non-recurring problems not mentioned above . .	<u>17</u>	<u>73</u>	<u>10</u>	<u>19</u>	<u>68</u>	<u>13</u>	<u>8</u>	<u>70</u>	<u>22</u>
SYSTEMS									
1. Review feasibility of use of a punched card system	<u>43</u>	<u>54</u>	<u>3</u>	<u>43</u>	<u>57</u>	<u>0</u>	<u>15</u>	<u>77</u>	<u>8</u>
2. Reviewing computer proposals . .	<u>37</u>	<u>60</u>	<u>3</u>	<u>43</u>	<u>57</u>	<u>0</u>	<u>15</u>	<u>70</u>	<u>15</u>
3. Performing computer feasibility studies	<u>53</u>	<u>44</u>	<u>3</u>	<u>43</u>	<u>57</u>	<u>0</u>	<u>37</u>	<u>48</u>	<u>15</u>
4. Supervising computer installation projects	<u>78</u>	<u>22</u>	<u>0</u>	<u>75</u>	<u>25</u>	<u>0</u>	<u>30</u>	<u>55</u>	<u>15</u>
5. Systems analysis	<u>50</u>	<u>42</u>	<u>8</u>	<u>30</u>	<u>57</u>	<u>13</u>	<u>15</u>	<u>63</u>	<u>22</u>
MARKETING									
1. Market analysis	<u>75</u>	<u>25</u>	<u>0</u>	<u>94</u>	<u>6</u>	<u>0</u>	<u>78</u>	<u>22</u>	<u>0</u>
2. Sales management: prices, channels of distribution	<u>63</u>	<u>34</u>	<u>3</u>	<u>81</u>	<u>19</u>	<u>0</u>	<u>70</u>	<u>30</u>	<u>0</u>
3. Sales forecasting	<u>53</u>	<u>47</u>	<u>0</u>	<u>75</u>	<u>25</u>	<u>0</u>	<u>46</u>	<u>46</u>	<u>8</u>
PERSONNEL									
1. Evaluation of personnel	<u>27</u>	<u>68</u>	<u>5</u>	<u>37</u>	<u>50</u>	<u>13</u>	<u>8</u>	<u>84</u>	<u>8</u>
2. Selection of personnel	<u>34</u>	<u>58</u>	<u>8</u>	<u>13</u>	<u>74</u>	<u>13</u>	<u>8</u>	<u>70</u>	<u>22</u>
3. Training of personnel	<u>27</u>	<u>63</u>	<u>10</u>	<u>30</u>	<u>57</u>	<u>13</u>	<u>22</u>	<u>70</u>	<u>8</u>
4. Analysis of wage compensation plan	<u>30</u>	<u>67</u>	<u>3</u>	<u>30</u>	<u>57</u>	<u>13</u>	<u>22</u>	<u>56</u>	<u>22</u>

TABLE 49 (Continued)

<u>Type Of Service</u>	Degree Of Occurrence Expressed As A Percentage According To A Professional Staff Of								
	<u>1-5</u>			<u>6-10</u>			<u>over 10</u>		
	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>	<u>N</u>	<u>OC</u>	<u>FR</u>
MATHEMATICAL TECHNIQUES									
1. Break-even analysis	29	66	5	13	87	0	30	62	8
2. Capital budgeting	40	55	5	25	75	0	30	48	22
3. Linear programming	90	10	0	100	0	0	78	14	8
4. Multiple regression	90	10	0	100	0	0	92	0	8
5. Simulation	92	8	0	94	6	0	92	0	8
6. Operations research techniques not mentioned above	33	17	0	70	30	0	70	22	8

Note: N, OC, and FR are abbreviations for Never, Occasionally, and Frequently, respectively.

VITA

John Moody Malloy, the son of John Coit and Irene Moody Malloy, was born September 9, 1938, in Dallas, Texas. He graduated from Waxahachie High School, Waxahachie, Texas, in May, 1957, and entered Southern Methodist University, Dallas, Texas, the following September. In May, 1961, he received the degree of Bachelor of Business Administration with a major in accounting from Southern Methodist University.

From June, 1961, to September, 1962, he was employed in the cost accounting department of the Dallas, Texas, office of Texaco, Inc. He attended the graduate school of Southern Methodist University from September, 1962, to May, 1963. From June, 1963, to July, 1964, he performed management type audits as a junior accountant for the U. S. General Accounting Office in Dallas, Texas. From July, 1964, to September, 1966, he was a senior auditor in the Dallas, Texas, office of Army Audit Agency which was later absorbed by the Defense Contract Audit Agency. He was granted a CPA certificate from the State of Texas after having passed the November, 1965, Uniform CPA Examination. In May, 1966, he was granted a Master of Business Administration degree from

Southern Methodist University with a major in accounting and a minor in business statistics.

In September, 1966, he entered the graduate school of Louisiana State University, Baton Rouge. From that date he was a graduate student and also taught in the Department of Accounting as a graduate assistant. In October, 1969, he joined the Department of Accounting of the University of Cincinnati, as Assistant Professor.

He is currently a candidate for the Degree of Doctor of Philosophy at Louisiana State University.

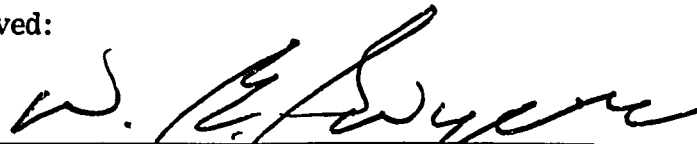
EXAMINATION AND THESIS REPORT

Candidate: John Moody Malloy

Major Field: Accounting

Title of Thesis: "Critical Evaluation of the Present And Future Role of the
Local Practitioner"

Approved:

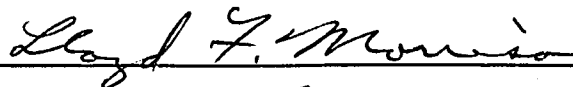


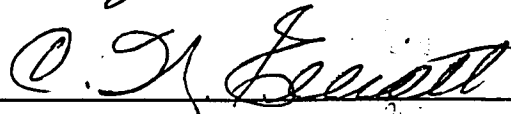
Major Professor and Chairman



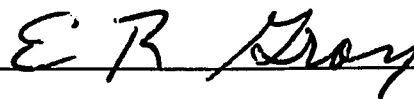
Dean of the Graduate School

EXAMINING COMMITTEE:









Date of Examination:

July 17, 1970